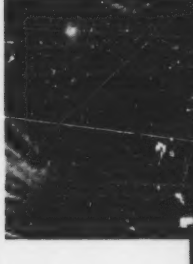
Office of the
Auditor General
of Canada

Manual on Special Examinations of Crown Corporations



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Foreword

The Special Examination Audit Manual is one of three product–line manuals resulting from the most recent update of the Comprehensive Auditing Manual (CAM). The purpose of the update was to:

- delayer the CAM to recognize the unique requirements of each product–line;
- clarify responsibilities and increase delegation to Assistant Auditors General and teams;
- differentiate between required practice and areas where professional judgment can be exercised; and
- take advantage of the Office's electronic tools (INTRAnet) while moving away from paper–based guidance.

This manual is applicable to all special examinations conducted by the Office. The other two are the Annual Audit and Value–for–Money manuals. Each manual is supported by functional guidance and other procedures and tools specific to the product–line. The delayered CAM will henceforth consist of these three product–line manuals together with the Office's Strategic Framework and Code of Professional Conduct.

The Special Examination Audit Manual has been built around professional standards and Office policies that examiners must meet to produce a high–quality audit. The Manual has a strong quality orientation based on current thinking and practice in first–class professional organizations. It clarifies the standard of quality expected from staff and encourages greater professional judgment.

The Special Examination Audit Manual is the product of extensive consultations with practitioners in the Office, the Practice Development Committee, Office specialists including functional responsibility leaders, as well as external consultants.

The Manual is expected to be a focal point for the continuous improvement of our special examination practice. Our experience with special examinations continues to expand and evolve; so will this manual. If you wish to suggest additional issues that should be covered, or to offer any other comments or suggestions for improving the Manual, please contact the Functional Responsibility Leader for special examinations.

L. Denis Desautels, FCA
Auditor General of Canada
1st September 2000

Introduction

Purpose of the Manual

1. The Office currently has four product lines: annual audits of the financial statements of Crown corporations and other entities and of the Government of Canada; Special Examinations of Crown corporations; value–for–money (VFM) audits of departments and agencies and studies; and environment and sustainable development audits and studies. The Practice Development Committee of the Office approves policies, standards and expected practices for each product line, with the objective of ensuring that these standards are maintained at the highest professional level.

2. The Office's Comprehensive Auditing Manual (CAM) has been updated and delayered. The delayered CAM, portrayed in Exhibit 1, will henceforth consist of three product line manuals, together with the Office's Strategic Framework and Code of Professional Conduct, and will be electronically linked to other Office policies as appropriate.

3. This manual sets out the auditing policies that govern the conduct of Special Examinations of Crown corporations and provides guidance to examiners on the approach including compliance with the policies. The purposes of the manual are to:

- assist users to achieve the highest possible level of quality in Special Examinations;
- promote the highest possible level of professional competence in Office staff;
- provide a basis for measuring audit performance; and
- allow others outside the Office to gain a better perspective and understanding of the practices and professionalism of the Office.

Applicability

4. This product manual is intended for Office practitioners for the conduct of all special examinations.

5. **Scheduled Crown corporations.** The *Financial Administration Act* (FAA) requires the board of directors of all Schedule III Part I and II Crown corporations and their wholly owned subsidiaries to cause a special examination to be carried out at least once every five years. Also, some wholly owned subsidiaries have been designated by Governor in Council to report their affairs as if they were parent Crown corporations.

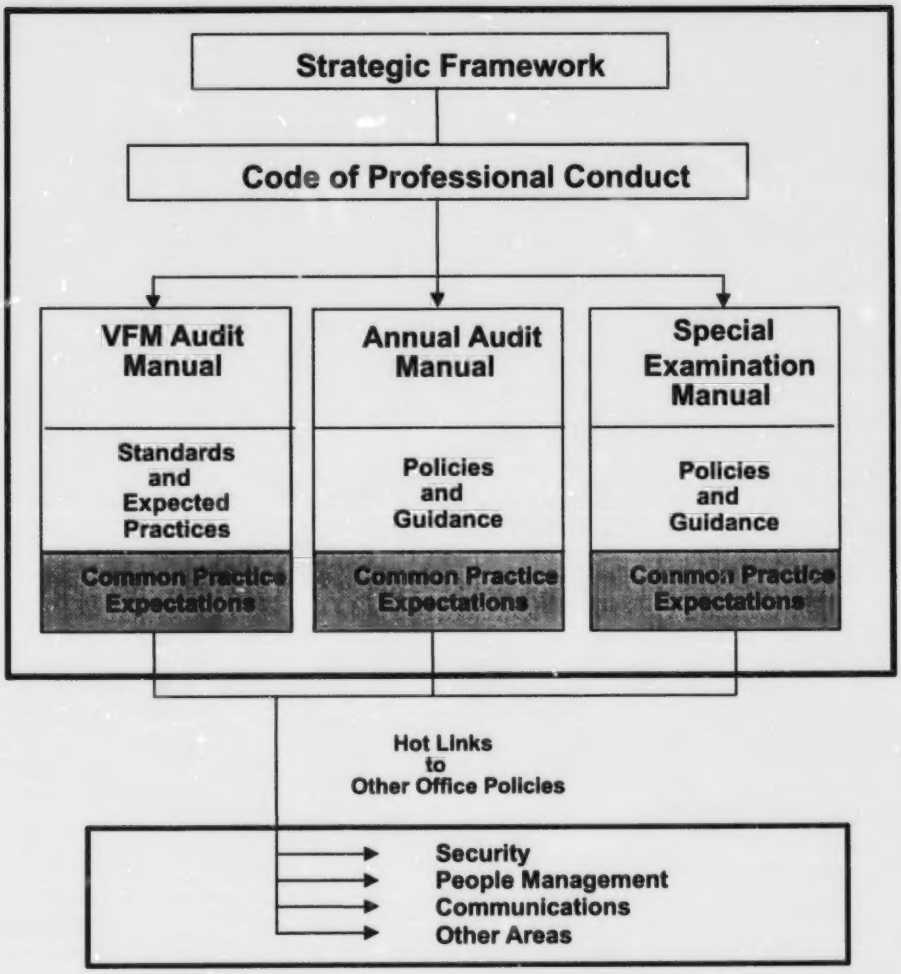
6. **Other Crown corporations.** In addition, other Crown corporations exempt from Part X of the FAA may be subject to similar special examination provisions. For example, the Canadian Broadcasting Corporation through revisions in its enabling legislation in 1991 (the Broadcasting Act) is required to have a special examination carried out in the same fashion as corporations subject to Part X of the FAA. As well, other exempt Crown corporations that do not have provisions for special examinations can and have requested through an Order in Council that the Office carry out a special examination on their corporation (e.g., National Arts Centre).

Organization of the Manual

7. The manual is composed of four parts.

Exhibit 1

Updated CAM Framework



8. The first part contains Chapters 1 to 3 and provides context for special examinations through a review of the Crown corporation control and accountability framework, the nature of special examinations, and compliance requirements for the conduct of special examinations.

9. The second part contains Chapters 4 to 7 and deals with the key elements of planning a special examination, including understanding the business and corporate governance, selecting key areas for in–depth examination and criteria selection.

10. The third part comprises Chapter 8 and discusses the processes involved in the conducting phase of a special examination.

11. The fourth part comprises Chapter 9 and covers reporting the special examination

Framework and General Approach

1 *The Crown Corporation Control and Accountability Framework*

Corporate Environment

12. Crown corporations operate in a complex and rapidly changing environment. Corporations in the private sector operate with the understanding that maximizing shareholder wealth is the major priority. However, the primary objectives for public–sector entities are not as clear–cut. While all Crown corporations must meet public–policy objectives, such as delivering needed public services even when they may not be commercially viable, many Crown corporations must also achieve self–sufficiency. Varied and sometimes conflicting purposes shape complex Crown corporations, which may use revenues generated by their commercial activities to help support efforts to serve the public interest.

13. Because Crown corporations are financed either directly by the government or by lenders who rely upon the government's guarantee, they may not be subject to the same commercial discipline as private–sector organizations. Many Crown corporations are accorded the legal status of Crown agents (that is, "agent of Her Majesty" status), which confers a variety of potential legal immunities, including, for example, exemption from corporate taxes.

Financial Administration Act

14. **Part X**. The *Financial Administration Act* (FAA), Part X, provides the control and accountability framework for parent Crown corporations and their subsidiaries. Its objective is to strike a balance between the need for adequate control and direction by Parliament and government on the one hand, and the need for an appropriate measure of independence of action and accountability by the corporations on the other. The Office has supported the regime for control and accountability established by the Act for Crown Corporations. The framework provides a number of key features, including:

- a clear explanation of "who is responsible for doing what" (Parliament, government, board and management);
- good planning and reporting provisions; and
- a well–defined, rigorous audit regime (internal audit, attest and special examinations).

15. **Part I, Part II and exempt Crown corporations**. If we consider all of the FAA schedules, we see a continuum from those government entities that play a more significant public–policy role to those that play a less significant public–policy role (that is, from departments (Schedule 1) to departmental corporations (Schedule 2) to Part I

Crown corporations to Part II Crown corporations (Schedule 3)). This position is supported both by the way in which the government portrays such entities and by the recent government practice of privatizing Part II Crown corporations.

Part I Crown corporations:

- have significant public–policy roles and are therefore usually in a more monopolistic situation;
- are dependent to different extents on government funding;
- are subject to the control and accountability framework of Part X of the FAA;
- are subject to audit or joint audit by the AG, unless the AG waives that requirement (s.134(2) of the FAA); and
- in the case of wholly–owned subsidiaries, are examined by auditors appointed by the board of directors of the parent Crown corporation.

Part II Crown corporations:

- may have less significant public–policy roles than Part I corporations;
- can eventually be privatized – many significant Crown corporations have been privatized over the years (Canadair in 1986, Teleglobe in 1987, Air Canada in 1989, Petro–Can in 1992 and 1996 and CN in 1996);
- do not have to submit an operating budget to the appropriate minister for approval of Treasury Board (TB) on the recommendation of the minister. (s.123);
- must annually submit a dividend proposal to the appropriate minister as part of its Corporate Plan (s.130.1);
- do not have special examination reported beyond the board of directors. For Part I corporations, special examination reports can go to the Minister or Parliament. (ss.140, 141);
- have an auditor appointed annually by the Governor in Council, after the appropriate minister has consulted the board of directors of the corporation, unless other Acts specify the AG as auditor. (s.134(1) & (3));
- in the case of wholly–owned subsidiaries, have an auditor appointed by the board of directors of the parent Crown corporation; and
- must meet the conditions of subsection 3(5) of the FAA, that is, the Governor in Council must be satisfied that:
  - the corporation operates in a competitive environment;
  - the corporation is not ordinarily dependent on appropriations for operating purposes;
  - the corporation ordinarily earns a return on equity; and
  - there is a reasonable expectation that the corporation will pay dividends.

Exempt Crown corporations:

- are not subject to Divisions I to IV of Part X of the FAA, which means that they are not subject to certain provisions that support good management and accountability. For example, they are not required to prepare and submit corporate plans and budgets to the government for review and approval and for tabling in Parliament, and they do not have to submit to internal audits and special examinations – unless it is specified in their enabling legislation (e.g., CBC);

- were exempted because of the perceived need to protect the special nature of their relationship to the Government – that is, a degree of independence from political and bureaucratic control; and
- are either subject to audit by the AG or by a private sector auditor (usually appointed with Governor in Council approval) as specified in the enabling legislation.

Roles and Responsibilities

16. One of the main issues in drafting the legislative amendments to the *Financial Administration Act* (FAA) in 1984 was the need to clarify the roles and responsibilities of the various players. Although these roles and responsibilities are now clarified in Part X of the FAA, it is important that all parties in the accountability chain fulfil their responsibilities. The notion of governance relates to how those responsibilities are carried out. Exhibit 2 outlines the main elements of the control and accountability framework.

17. **Parliament** approves the creation, acquisition, disposal or dissolution of any parent Crown corporation. As in other matters, Parliament is responsible for scrutinizing and authorizing the expenditure of public funds and for holding the government to account for achieving public policy objectives. In order for Parliament to be able to do this, the FAA requires that summary corporate plans and annual reports prepared by corporations, and Treasury Board's annual consolidated report on the businesses and activities of all parent Crown corporations, be provided to Parliament.

18. **The appropriate minister** is designated to act as the "trustee" shareholder. The minister serves as an interface between the Crown corporation on the one hand and Parliament, the Governor in Council, and Treasury Board on the other. The appropriate ministers are responsible for holding Crown corporations to account.

Exhibit 2

Main Elements of Crown corporation Control And Accountability Framework

	Parliament	Governor in Council	Treasury Board	Minister	Board of Directors
Plans/Budgets					
Corporate Plan		Approve	Review	Recommend	Submit
Operating Budget			Approve	Recommend	Submit
Capital Budget			Approve	Recommend	Submit

	Parliament	Governor in Council	Treasury Board	Minister	Board of Directors
Reports					
Summaries of Plans/Budgets	Receive			Approve	Submit
Corporate Annual Report	Receive			Receive	Submit
Annual Consolidated Report	Receive		Prepare		
Annual Report on Tablings	Receive		Prepare		
Directives	Receive	Approve		Recommend	Advise
Creation, Acquisition Disposal, Dissolution					
Parents	Approve		Review	Recommend	
Subsidiaries		Approve	Review	Recommend	
Appointments					
Directors		Approve		Appoints	
Officer Directors (CEO)		Appoint		Recommend	Advise
Officers (excl. CEO)					Appoint
Auditors of Parent CCs		Appoint		Recommend	Advise
Audits					
Internal Audit					Receive
Annual Audit	Receive			Receive	Receive
Special Examination	May receive			May receive	Receive

19. **The board of directors** is responsible for "the management of the businesses, activities and other affairs of the corporation." Therefore, the board of directors represents the corporation and is accountable to the appropriate minister for the fulfilment of its corporate duties.

20. **Management.** Although it is the board that the government holds ultimately responsible for corporate performance, the board must rely on the chief executive officer and senior management of the corporation to develop and implement corporate plans, to manage day–to–day operations and to keep the board informed of problems and opportunities so that they can act promptly. In the final analysis, it is the chief executive officer's function to manage the operations of the corporation effectively.

21. **Reference.** For a discussion of roles and responsibilities in Crown corporations, see the *Report of the Auditor General*, 1995, Chapter 10, Crown Corporations: Fulfilling

Responsibilities for Governance; and *Report of the Auditor General*, 1993, Chapter 4, Crown Corporations: Accountability for Performance.

The Audit Regime and the Examiner's Responsibilities

22. Audit is a process superimposed on the accountability relationship to provide additional, independent assurance to those who allocate responsibility.

23. **Reference.** For an extensive discussion of the audit regime and special examiner's responsibilities, see *Report of the Auditor General*, 1990, Chapter 6, The Audit Regime for Crown Corporations.

24. Part X of the FAA sets out an elaborate, and in many respects innovative, audit regime for Crown corporations. The audit regime flows from management responsibilities. Management responsibilities, internal audits, annual audits and special examinations are all intended to work in concert. **Exhibit 3** illustrates the interrelationship of these three types of audit.

25. The corporation is required to maintain financial and management control, information systems and management practices in such manner as will provide reasonable assurance that:

- the assets of the corporation are safeguarded and controlled;
- the transactions of the corporation are in accordance with Part X of the FAA, with the regulations, the charter and by–laws of the corporation, and with any directive given to the corporation;
- the financial, human and physical resources of the corporation are managed economically and efficiently; and
- the operations of the corporation are carried out effectively.

26. **Internal audit** assesses for management the adequacy of these systems and practices. Although the FAA allows for internal audit to be waived if the Governor in Council believes that the costs outweigh the benefits, such exemptions have been subject to stringent review by Treasury Board, given the importance of the function. For examples of corporations that have been exempted from internal audits, see **Exhibit 4**.

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Exhibit 3

The Audit Regime in Crown Corporations

Corporation's Responsibility (FAA, 131 [1g] and 131 [2a and c])

To keep books and records, and to maintain systems and practices to provide reasonable assurance that:

(a) assets are safeguarded and controlled;
(b) transactions are in accordance with specified authorities;
(c) resources are managed economically and efficiently; and
(d) operations are carried out effectively.

To report on plans, results of operations, financial position, and performance against plan.

Internal Audit (FAA, 131 [3])	Annual Audit (FAA, 132 [1])	Special Examination (FAA,138[1])
Purpose: To assess compliance with the requirement to keep books and records and to maintain systems and practices that provide reasonable assurance that: (a) assets are safeguarded and controlled; (b) transactions are in accordance with specified authorities; (c) resources are managed economically and efficiently; and (d) operations are carried out effectively.	**Purpose:** To provide independent opinions on: (a) fairness of presentation of financial statements; (b) accuracy of quantitative information (if requested to do so by Treasury Board); and (c) compliance with specified authorities. To call Parliament's attention to any other matter as appropriate.	**Purpose:** To determine whether, in the period under examination, the systems and practices maintained provided reasonable assurance that: (a) assets were safeguarded and controlled; (b) resources were managed economically and efficiently; and (c) operations were carried out effectively.
Frequency: Ongoing	**Frequency:** Annual	**Frequency:** At least once every five years
Reporting to: Management	**Reporting to:** Appropriate minister, who tables the annual report of the corporation in Parliament	**Reporting to:** Board of directors, and as necessary in opinion of examiner (for Part I Schedule III corporations), to appropriate minister or Parliament

Reliance on internal audit to extent practicable

Exhibit 3

The Audit Regime in Crown Corporations

Corporation's Responsibility (FAA, 131 [1g] and 131 [2a and c])

To keep books and records, and to maintain systems and practices to provide reasonable assurance that:

(a) assets are safeguarded and controlled;
(b) transactions are in accordance with specified authorities;
(c) resources are managed economically and efficiently; and
(d) operations are carried out effectively.

To report on plans, results of operations, financial position, and performance against plan.

Internal Audit (FAA, 131 [3])

Purpose:
To assess compliance with the requirement to keep books and records and to maintain systems and practices that provide reasonable assurance that:
(a) assets are safeguarded and controlled;
(b) transactions are in accordance with specified authorities;
(c) resources are managed economically and efficiently; and
(d) operations are carried out effectively.

Frequency:
Ongoing

Reporting to:
Management

Annual Audit (FAA, 132 [1])

Purpose:
To provide independent opinions on:
(a) fairness of presentation of financial statements;
(b) accuracy of quantitative information (if requested to do so by Treasury Board); and
(c) compliance with specified authorities.

To call Parliament's attention to any other matter as appropriate.

Frequency:
Annual

Reporting to:
Appropriate minister, who tables the annual report of the corporation in Parliament

Special Examination (FAA,138[1])

Purpose:
To determine whether, in the period under examination, the systems and practices maintained provided reasonable assurance that:
(a) assets were safeguarded and controlled;
(b) resources were managed economically and efficiently; and
(c) operations were carried out effectively.

Frequency:
At least once every five years

Reporting to:
Board of directors, and as necessary in opinion of examiner (for Part I Schedule III corporations), to appropriate minister or Parliament

Reliance on internal audit to extent practicable

27. **Annual audit** provides assurance to Boards, ministers, Parliament and Treasury Board respecting financial statements, compliance with authorities and other matters of significance.

28. The **special examination** provides an independent and objective assessment of the corporation's management systems and practices. The examiner's responsibility is to carry out a special examination and express an opinion on whether there is reasonable assurance that during the period under examination there were no significant deficiencies in the systems and practices examined. The nature of special examinations is discussed at length in Chapter 2.

29. **Integrated Special Examination System (ISES).** To assist examiners in conducting special examinations effectively and efficiently in a manner that complies with the methodology adopted by the Office and contained in this Manual, a Lotus Notes–based audit software tool, called the Integrated Special Examination System (ISES), is available and is strongly recommended for use.

Exhibit 4

Internal Audit – Exemptions

The following is a list of Crown corporations that have from time to time been exempted from performing internal audits:

Atlantic Pilotage Authority
Canada Development Investment Corporation
Great Lakes Pilotage Authority
Laurentian Pilotage Authority
National Arts Centre
Pacific Pilotage Authority
Standards Council of Canada

Note: The actual status of any corporation with respect to this exemption at a specific point in time should be confirmed by referring to the Order in Council.

2 The Nature of Special Examinations

Introduction

30. Special examinations are an integral part of the Crown corporation control and accountability regime, and represent an important part of the work of the Office. They require the examiner and the corporation to address fundamental questions, such as what risks the corporation faces in achieving its objectives and mandate and how those risks are managed. By raising such questions, the special examination may suggest that corporations make these issues part of the management process.

31. Further, systems and practices are an essential component of the examiner's opinion, and the examiner must obtain sufficient evidence concerning the systems and practices and the results achieved before issuing an opinion.

32. In a special examination of a Crown corporation, it is impractical and inefficient to thoroughly examine the myriad of systems and practices, as many of the organizations are very large and complex. The examiner takes a broad perspective of the organization and of the results it is expected to achieve, while focussing on areas critical to the corporation's overall success. The planning approach must be to never lose sight of the corporation's objectives, to assess the risks against the achievement of those objectives, and to focus on systems and practices that address the most important risks.

33. Special examinations help to improve the Government's finances and information on its financial condition by identifying instances where Crown corporations can improve their productivity, operational efficiency, internal costing information, overall performance (including financial) reporting, cost recovery and self–sufficiency.

34. Special examinations help to advance accountability concepts and improve accountability practices in government, as these areas receive in–depth attention as part of the process. They also influence the quality of financial management in government by identifying instances where Crown corporations can improve on these practices (as well as other management practices).

35. Special examinations contribute to necessary changes in the Crown corporations sector of the Public Service – for example, by identifying instances where they can improve their human resource management systems and practices.

36. As well, where environmental issues are found to be significant, an in–depth examination will be performed and any significant deficiency reported.

Mandate for Special Examinations

37. **Statutory control objectives.** The mandate for special examinations is set out in section 138 of the FAA. The purpose of the special examination is to provide an independent, objective opinion on whether the corporation's financial and management control, information systems and management practices were, during the period under examination, maintained in a manner that provided reasonable assurance that:

- the assets of the corporation were safeguarded and controlled;
- the financial, human and physical resources of the corporation were managed economically and efficiently; and
- the operations of the corporation were carried out effectively.

38. These elements of the control framework are general statements of management's responsibilities, and are referred to in this guide as the "statutory control objectives." The corporation is required to put in place systems and practices to ensure that the statutory control objectives are achieved.

39. In a general way, "systems" refers to formal procedures (what is to be done), while "practices" refers to actual informal working arrangements (what is being done). Although the two terms are mostly used together, they are not synonymous.

40. **Assurance.** The examiner provides an opinion to the board of directors on whether the systems and practices provide reasonable assurance that the statutory control objectives have been achieved during the period under review.

41. The special examination is not intended to be an audit of the board of directors or of its role, but rather an examination of those systems and practices needed to provide reasonable assurance that desired results are being achieved. Expressed another way, the examiner assures the board that managers who have been delegated the authority to manage are performing their roles by assessing whether the required systems and practices are in place. The examiner reports to the board and may comment on the quality of the information provided to it, but does not attest to the quality of the board.

42. **Limitation.** Section 145 of the FAA states that the examiner is not authorized to express any opinion on the merits of matters of policy, including the merits of:

- the objects or purposes for which the corporation is incorporated, or the restriction on the businesses or activities that it may carry on, as set out in its charter;
- the objectives of the corporation; and
- any business or policy decision of the corporation or of the Government of Canada.

43. The concern underlying these provisions is that auditors, with the benefit of hindsight, should not be seen to second–guess the corporation's management, board or the Government regarding policy decisions taken. Instead, examiners are to render their opinions on whether policies are being carried out economically, efficiently and effectively, and with due regard for the control and protection of assets. This is a limitation on the type of opinion that can be given and should not limit the areas subject to examination. For example, the examiner may consider how strategic decisions are made and what information is used in decision–making, but should not comment on the merits of the policy decisions made. There is no restriction on commenting on whether these decisions result in inefficient, uneconomic or ineffective operations.

Characteristics of Special Examinations

44. **General characteristics.** A special examination is a form of VFM audit, except that it provides an opinion. In a special examination opinion, the examiner reports that, other than those identified and reported, there are no deviations from criteria that would cause the examiner to report a significant deficiency. The nature of the opinion reflects the requirements of the FAA.

45. There is also a difference between an annual audit and a special examination, although both are full scope. In an annual audit, the opinion is with respect to the financial position and financial results of the corporation's operations, whereas in a special examination, the opinion is with respect to the achievement of the statutory control objectives by way of the corporation's systems and practices. Also, in a special examination there is no explicit management representation as there is in the case of an annual audit (that is, the management representation is the financial statement)

46. The requirement for this unique type of opinion has a direct bearing on the general approach to special examinations. Because of the need to give an opinion, the special examination team normally begins by forming a broad understanding of the whole entity. Because the examination opinion must relate to the organization as a whole, a most important part of the audit evidence is the rationale for selecting certain systems and practices for in–depth examination.

47. There are many similarities and differences among special examinations, other types of VFM audits and annual attest audits. (see **Exhibit 5**). These characteristics are discussed below.

Exhibit 5

Crown Corporation Audit Opinion Comparisons

	VFM Audits	Special Examination	Annual Audits
Mandate	AG Act	FAA	FAA
Recipient of Report	Parliament	Board (directly), others by exception, Minister and Parliament (indirectly)	Minister and Parliament (tabled)
Scope of Opinion	Selective	Full	Full
Nature of Opinion	Reporting conclusions on audit objectives	Opinion	Opinion
Type of Report	Custom	Standard/Custom	Standard
Yardstick	Direct reporting against criteria	Direct reporting against criteria	Attestation against GAAP for F/S Direct reporting for compliance
Internal Audit Reliance	Optional	Required (to extent practical)	Required (to extent practical)
Frequency	No fixed schedule	At least once every five years	Every year
Auditing Standards	OAG VFM Standards	CICA Standards for Assurance Engagements	CICA Generally Accepted Auditing Standards (GAAS)

48. **The auditor's mandate** for special examinations and annual audits of Crown corporations is derived from the FAA. Value–for–money audits, other than the special examination, are provided for under the *Auditor General Act*. The mandate with respect

to effectiveness is also somewhat different. A VFM audit carried out under the *Auditor General Act* relates to the presence of procedures to measure and report effectiveness; however, under the FAA, the opinion is on whether there is reasonable assurance that operations are carried out effectively.

49. The primary **recipient of the report for special examinations** is the board of directors, since the board is responsible for the affairs of the corporation (as per FAA s.109). Reporting beyond the board of directors is done only in exceptional circumstances. In the case of corporations named in Schedule III–I of the FAA, results may be reported to the responsible minister and/or Parliament. Also, the Office has reported to Parliament through chapters of the *Auditor General's Report* on the special examination process, as well as in the overall results of the special examinations.

50. The **scope of the opinion** required is broader for a special examination than for other types of VFM audit. Other types of VFM audit report conclusions against audit objectives (that is, a selective–scope conclusion is given). In a special examination, however, the examiner must give an opinion that encompasses all systems and practices that are (or should be) maintained by the corporation (that is, a full–scope opinion is given). Value–for–money auditing, under the *Auditor General Act*, is often essentially a form of exception reporting. The special examination opinion, rendered under the FAA, is all–encompassing inasmuch as it provides an opinion and covers even those systems and practices that were not examined in depth.

51. However, since it is not intended – nor is it practical or efficient – to do a "wall–to–wall" examination, the examiner needs to determine beforehand what deficiencies, if any exist, could be significant, and to concentrate the examination effort in those particular areas. The examiner does this by focussing on areas of risk and the related systems and practices. At the same time, it is important to retain a view of the whole corporation throughout the special examination.

52. **Type of report.** For other types of VFM audit, there is generally no standardized wording in the report. For special examinations, because the FAA requires certain statements from the examiner with regard to the criteria, significant deficiencies and the extent of reliance on internal audit, the Office has developed a template for certain areas of the report (refer to Appendix 3). Beyond that, the legislation does not specify the type of report required. However, the Office's standard is to issue a long–form report, which includes the matters required by statute but goes beyond that minimum to discuss the overall context and the impact of significant deficiencies as well as other matters that may be significant. By using a long–form special examination report, the Office seeks to meet its statutory obligation and to add further value for the corporation.

53. **Direct reporting against criteria.** For all VFM audits, including special examinations, the auditor reports directly against agreed criteria, rather than attesting to a report prepared by management, as is the case in a financial statement audit. Again, unlike audits of financial statements, which are based on generally accepted accounting principles, special examinations and other VFM audits must select suitable and appropriate criteria, as there are no generally accepted management principles. Therefore, the Office, in consultation with the corporation, selects specific criteria for each examination. The Office selects these criteria based on its knowledge and experience with VFM auditing; by reference to legislative and regulatory requirements and to standards and practices followed by the Corporation and other organizations; and by the reference to professional literature.

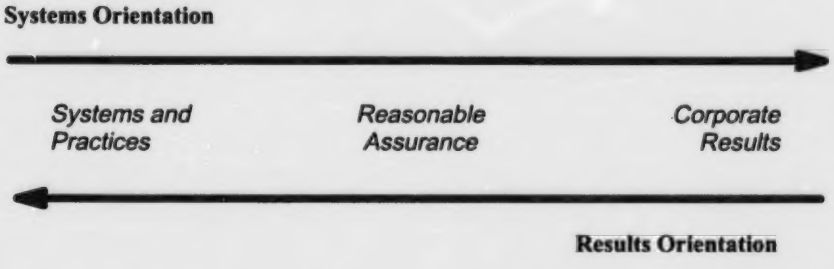
54. **Internal audit** must be relied upon to the extent practical for annual audits and special examinations (as specified in the FAA), whereas other VFM audits have no such legislative requirement.

Results Orientation

55. Since systems and practices are only means to ends, they need to be judged by their ability to achieve those ends. In other words, the function of systems and practices is to support the achievement of preferred outcomes. The special examination opinion is on whether systems and practices provide reasonable assurance that the corporation's results are being achieved (this is generally equivalent to the statutory control objectives being achieved: operations are carried out effectively, assets are safeguarded and controlled, and resources are managed economically and efficiently).

56. Observing **Exhibit 6** from right to left (a results orientation), the examiner would start with the statutory control objectives – the results that systems and practices are intended to achieve – and consider if, in fact, these results ARE being achieved. If they are not, the cause (that is, the system or practice that is deficient or missing) is identified and reported in whole or in part as a significant deficiency.

Exhibit 6



57. Looking at **Exhibit 6** from left to right (a systems approach), the examiner would assess systems and practices to determine if the statutory control objectives are being achieved. If deficiencies are found in the systems or practices, a determination of their effect on the statutory control objectives is made to determine the ultimate significance of the deficiencies.

58. The results–oriented approach and the systems–oriented approach are closely linked and the difference is simply a matter of emphasis. Theoretically, either orientation should bring the special examiner to the same opinion. However, the Office has determined that the results orientation produces more effective auditing and better use of limited resources. The results–oriented approach, it is recognized, requires a high degree of professional judgment combined with considerable and appropriate audit experience.

59. The Office has chosen to adopt the results focus because:

- it will direct the examiner to areas where deficiencies could be significant;
- it is usually less costly, since only those systems and practices essential to achieving expected results are examined in depth;
- it is more relevant to the board and senior management because it focusses on matters that affect the corporation's success; and
- it is easier to assess the significance of audit results by demonstrating their impact on the achievement of expected results and, by extension, on the statutory control objectives.

60. In order to be results–oriented, the special examination must begin with a clear understanding of the desired results. What does the corporation have to achieve to be successful (that is, to meet its mandate in an economical and efficient manner)?

Significance

61. The FAA does not define "significant deficiency"; it merely indicates that significant deficiencies will be determined by reference to criteria. For CICA guidance, see **Exhibit 7**.

62. Significance is a matter of judgment and depends on the particular circumstances. The users of the report must be kept in mind. In special examinations, significance is judged in terms of the extent to which a matter might affect, or be of concern to, the board of directors, the responsible minister or Parliament. Similarly, the impact of a deficiency is a consideration. In special examinations, the impact of the deficiency on the achievement of the statutory control objectives (or the corporation's key results) should be demonstrable. Only high–level issues would concern the board, the minister or Parliament, and they are likely to be few.

Exhibit 7

Guidance on "Significance" CICA Standard PS 6410

In value–for–money auditing, significance consists of qualitative and quantitative considerations, including:

(a) Financial magnitude. Generally, areas with larger dollar amounts and flows warrant more attention.

(b) Importance. Entities have programs, operations or activities that are essential to achieving their objectives.

(c) Economic, social and environmental impact. Although a project or program in the entity may have a relatively small budget, it may affect a large segment of the population or the environment.

(d) Management action with respect to important issues previously raised. The auditor may attach greater significance to those areas where management has not made adequate improvements to address important issues raised in prior audits or other studies.

(e) Interest expressed in the matters. Interest may be shown by the legislature or other governing body, by management of the entity or by the public. If attention is being paid to the matters, the auditor would consider whether to address those matters in the audit.

(f) Impact of a centralized function. Central budgeting, payroll, payments, personnel, property management and administration are examples of centralized functions. The effect that those functions can have on other entities or on portions of an entity may be more significant than their size or nature may otherwise indicate.

Reasonable Assurance

63. The use of the terms "reasonable assurance" and "significant deficiency" in the opinion suggests the need for the exercise of judgment. The examiner judges which controls are reasonable, in light of the likelihood and magnitude of potential risks in relation to results. The corporation's systems and practices should provide reasonable assurance that the corporation's key results are being achieved. Reasonable assurance recognizes that the cost of managing risks should not exceed the benefits likely to be derived.

64. As such, reasonable assurance implies a satisfactory level of confidence under given considerations of costs, benefits and risks – it does not mean absolute or total assurance. The corporation (the board as well as management) should take steps to control outcomes within a tolerable range for an acceptable portion of the time, but cannot guarantee that there will never be outcomes that fall outside this range. The examiner determines what constitutes a "tolerable" range of outcomes for an "acceptable"

portion of the time in each case, based on conditions specific to the corporation under consideration (for example, industry norms and perceived risks and rewards).

65. In addition, the examiner weighs the requirements for sufficient evidence to meet the obligation to provide an opinion against the cost of acquiring the evidence. The examiner expresses an opinion as to whether there is reasonable assurance that there are no significant deficiencies in systems and practices.

Audit Level of Assurance

66. An audit level of assurance is required for special examinations. Assurance is the measure of the examiner's confidence that the report is not inappropriate or misleading. Audit assurance is based on the strength of the evidence supporting the conclusions.

67. Obtaining the desired level of assurance balances the risk of failing to report a significant deficiency with the cost of obtaining the appropriate evidence. Although cost should not be the primary consideration in determining the extent of examination work, the audit principal must nevertheless consider the resources required and seek to achieve the desired level of assurance at the minimum cost. This balance is determined in consultation with the AAG.

68. CICA Standards for Assurance Engagements allow for reporting two different levels of assurance. In accordance with the requirements of the FAA, special examinations provide an "audit" level of assurance.

Overview of the Special Examination Process

69. Like other types of audits, there are three main phases in the special examination – planning, conducting and reporting. Planning is especially important in the case of special examinations, as only certain systems and practices will be selected for in–depth examination. An important part of the audit evidence is the documentation of a thorough understanding of the corporation and its operating environment, and the rationale for selecting certain systems and practices to be examined in depth and not selecting others.

70. Following are the critical examination judgment areas (also refer to **Exhibit 8** and subsequent chapters):

- **Understanding the business.** An understanding of the corporation's mandate and objectives, expected and achieved corporate results, risk profile, organization, activities and operating environment provides the foundation for the rest of the special examination.
- **Identifying and evaluating risks.** Based on this understanding of the business, the examination team must identify the risks that would prevent the corporation's expected corporate results from being realized.
- **Selecting key areas (systems and practices).** The next step is to identify the systems and practices for managing those medium to high risks (that is, those systems and practices where deficiencies, if they exist, could be significant).
- **Selecting suitable criteria.** Criteria must relate to the overall purpose of the special examination and be at a level appropriate to the board of directors. The judgment as to the suitability of criteria is extremely important because the selected criteria drive the subsequent audit work and reporting.
- **Assessing systems and practices against criteria and determining the significance of any deficiencies.** The final critical judgment area is determining

whether criteria are met and evaluating the significance of any deficiencies identified. At this point, reporting beyond the board to the appropriate minister or to Parliament must be considered.

Risk Analysis

71. After gathering and analyzing information on the corporation's mandate and objectives, external environment, operations and corporate governance, the examiner must identify and consider the key mid– to long–term results that the corporation must achieve to be successful. With this knowledge, a risk analysis is done to determine the significant risks to the achievement of those expected corporate results and, consequently, the areas that need to be managed well to minimize those risks.

72. The risk analysis process includes two types of risks:

- General risks, defined for purposes of the special examination as any event that could prevent the corporation from attaining its expected corporate results (these would include corporate / strategic risks and operational risks); and
- Inherent risk, defined for purposes of the special examination as the likelihood and consequences of the event occurring.

73. For those events where the inherent risk is judged to be sufficiently important, the examiner identifies "key areas". That is, the examiner identifies the key systems and practices that are to be subjected to in–depth examination.

Advisory Committees

74. Special examination advisory committees are an essential component of the Office's special examination quality management system. Committee members are consulted at least twice and sometimes more often for the larger special examinations, regarding examination plans and preliminary conclusions as well as on contentious issues and reporting strategies.

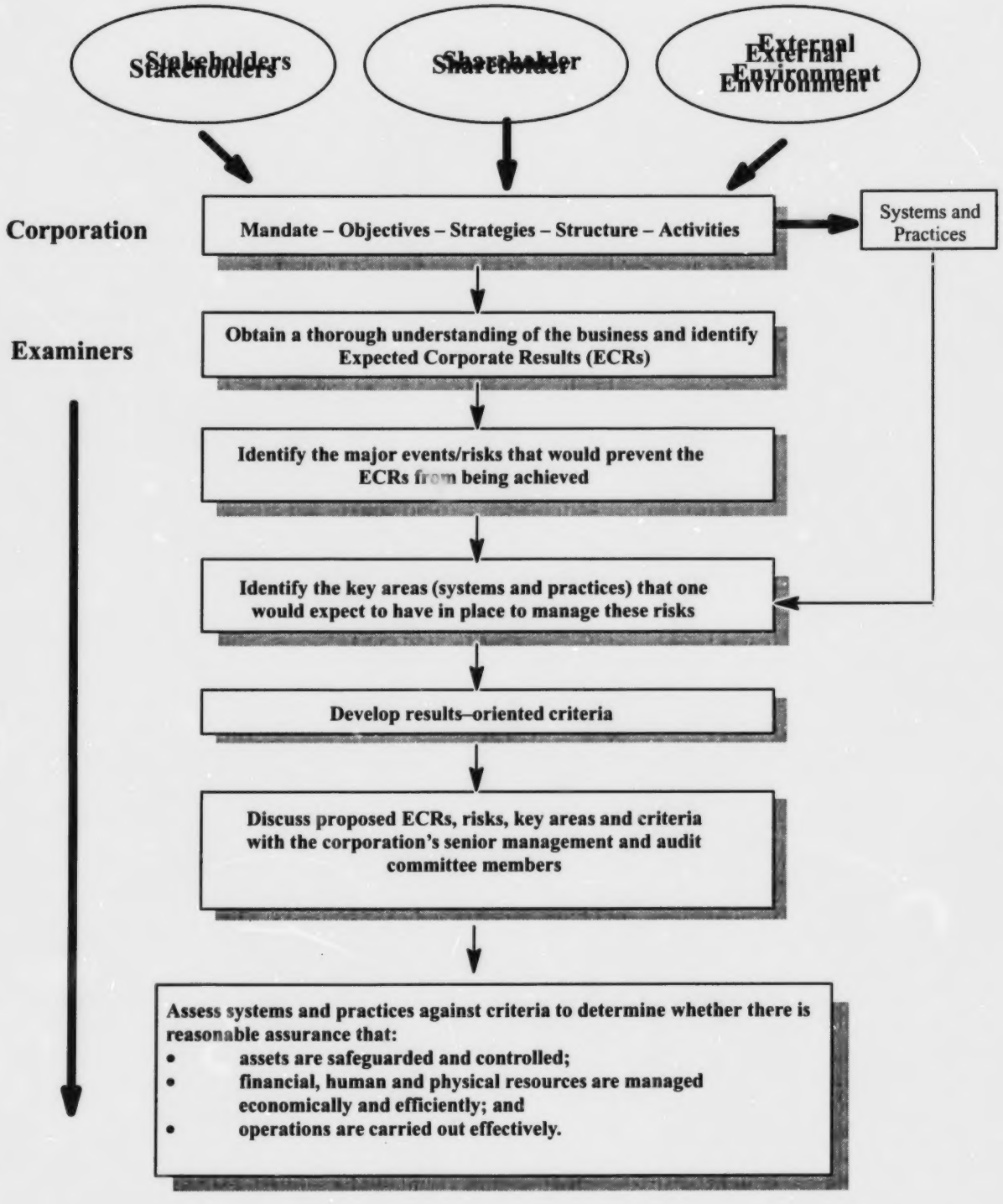
75. The use of advisory committees is not a legislative requirement, but reflects the Office's interest in ensuring that appropriate skills and experience are brought to each examination. Most advisory committees are composed of the chairperson, two or more representatives from outside the Office, and two or three others from inside the Office. Membership on the committee is based on the potential contribution of individuals to a specific examination, given their insights, skills, knowledge and experience.

Quality Management Requirements for the Conduct of Special Examinations

76. One of the key strategies of the Office of the Auditor General is to implement and maintain a co–ordinated and efficient Quality Management System (QMS) for all OAG products. **Appendix 1** identifies the quality management elements for special examinations and discusses the Office's key instruments and practices.

Exhibit 8

Overview of Key Special Examination Events


Stakeholders
Shareholder
External Environment
Corporation
Mandate – Objectives – Strategies – Structure – Activities
Systems and Practices
Examiners
Obtain a thorough understanding of the business and identify Expected Corporate Results (ECRs)
Identify the major events/risks that would prevent the ECRs from being achieved
Identify the key areas (systems and practices) that one would expect to have in place to manage these risks
Develop results–oriented criteria
Discuss proposed ECRs, risks, key areas and criteria with the corporation's senior management and audit committee members
Assess systems and practices against criteria to determine whether there is reasonable assurance that:
• assets are safeguarded and controlled;
• financial, human and physical resources are managed economically and efficiently; and
• operations are carried out effectively.

3 *Compliance Requirements for the Conduct of Special Examinations*

General Remarks

77. The special examination is subject to its own unique policies as well as to several other policies and standards, both internal and external to the Office, which it shares in common with other product lines of the Office. This chapter presents the special examination policies that are expanded upon and interpreted throughout the guide as well as highlights of other compliance requirements.

Special Examination Policies

78. All Office practitioners must comply with the expectations set out in the legislation pertaining to individual product lines, the OAG Strategic Framework, the OAG Code of Professional Conduct, and CICA Auditing Standards. The policies outlined below define practice expectations that complement or elaborate upon these requirements.

General Policies
1. Office practitioners should comply with CICA standards for assurance engagements, special examination policies, CAM common policies, and OAG special examination methodology. Any deviation should be approved by the examination Principal and the responsible Assistant Auditor General (AAG).
2. Where necessary, the Office should obtain the authority to undertake the special examination. Such authority would include an order in council under section 11 of the *Auditor General Act* for exempt Crown corporations, or an order in council under subsection 142(2) of the FAA where only one of the two joint auditors is to be the examiner.
3. Where the Office is involved in a joint special examination, the examination team should ensure that the work performed by the joint examiner is sufficient and appropriate to support the joint report.
4. As part of ongoing knowledge of the corporation, the entity team should be aware of the corporation's actions in response to significant deficiencies reported in past examinations.
5. Timely feedback should be sought from Crown corporation boards of directors and senior management on the special examination process and results.
6. Examination teams should collectively possess sufficient knowledge of the corporation's business and the industry in which it operates to ensure an efficient and effective examination with a focus on significance and a results orientation.

Policies Related to Consultation	
7.	"Where the Office is the auditor of a Crown corporation and is asked to conduct a follow–up of a special examination through a board resolution, acceptance of the mandate should be approved by the Executive Committee based on all relevant issues including availability of resources. The terms of the engagement should be documented in an engagement letter and the follow–up report to the Board should provide an audit level of assurance."
8.	The advisory committee (internal and external specialists and senior Office staff), the appropriate functional responsibility leaders (FRLs) and the second reviewer should be consulted when the issues are unusual, complex, controversial, or require specialized knowledge or experience. At a minimum, the examination team should obtain input at the following critical times:
•	Planning phase: when discussing expected corporate results, risks, key areas and examination criteria, and when drafting the examination plan;
•	Conducting and reporting phases: when discussing significance of deficiencies and reporting strategies, and when drafting the long–form special examination report.
9.	The examination team should keep the corporation informed about the existence and resolution of any sensitive examination issues.
Policies Related to the Planning Phase	
10.	The examination principal should be actively involved in all critical strategic planning decisions, including identification of expected corporate results, evaluation of risks, identification of key areas for detailed examination, and development of results–oriented criteria. These critical audit judgments should be adequately documented and reviewed by the AAG.
11.	While the examination opinion covers the corporation as a whole, the examination should focus on key areas critical to the achievement of expected corporate results, identified through a risk analysis.
12.	Criteria should have a results orientation, thereby identifying, where appropriate, the results to be achieved by the corporation's systems and practices.
Policies Related to the Conducting Phase	
13.	The examination team should prepare detailed audit plans or programs, setting out the sub–criteria and/or audit procedures that will meet examination objectives and ensure that sufficient and appropriate audit evidence is obtained. The examination principal should approve these plans, and any significant changes thereto, before they are implemented.
14.	The examination team should obtain sufficient and appropriate evidence to support its findings and its conclusions on the extent to which criteria are met.

Policies Related to the Reporting Phase
15. When one or more criteria are not sufficiently met, placing at risk the achievement of one or more statutory control objectives, the examination team should report a significant deficiency.
16. Examination findings should be reported beyond the board of directors of the Crown corporation when, in the Auditor General's opinion, they should be brought to the attention of the Minister or Parliament.
17. A Special Examination Report Clearance Memorandum in the approved format should be prepared and signed by the examination Principal, responsible AAG, DAG and the Auditor General to document the completion and clearance of the examination.
18. The examination team should issue a long–form special examination report on a timely basis. Any significant deficiency should highlight the problem, its cause and its effect.
19. The examination team should, on a timely basis and as appropriate, provide the corporation with other relevant information it has gathered during the examination.

Comparative Compliance Table

79. **Exhibit 9** summarizes the compliance requirements for the major categories of Office product lines, including special examinations.

* **At a minimum**, practitioners should comply with the methodology and practices (as outlined in this manual and ISES) relating to:

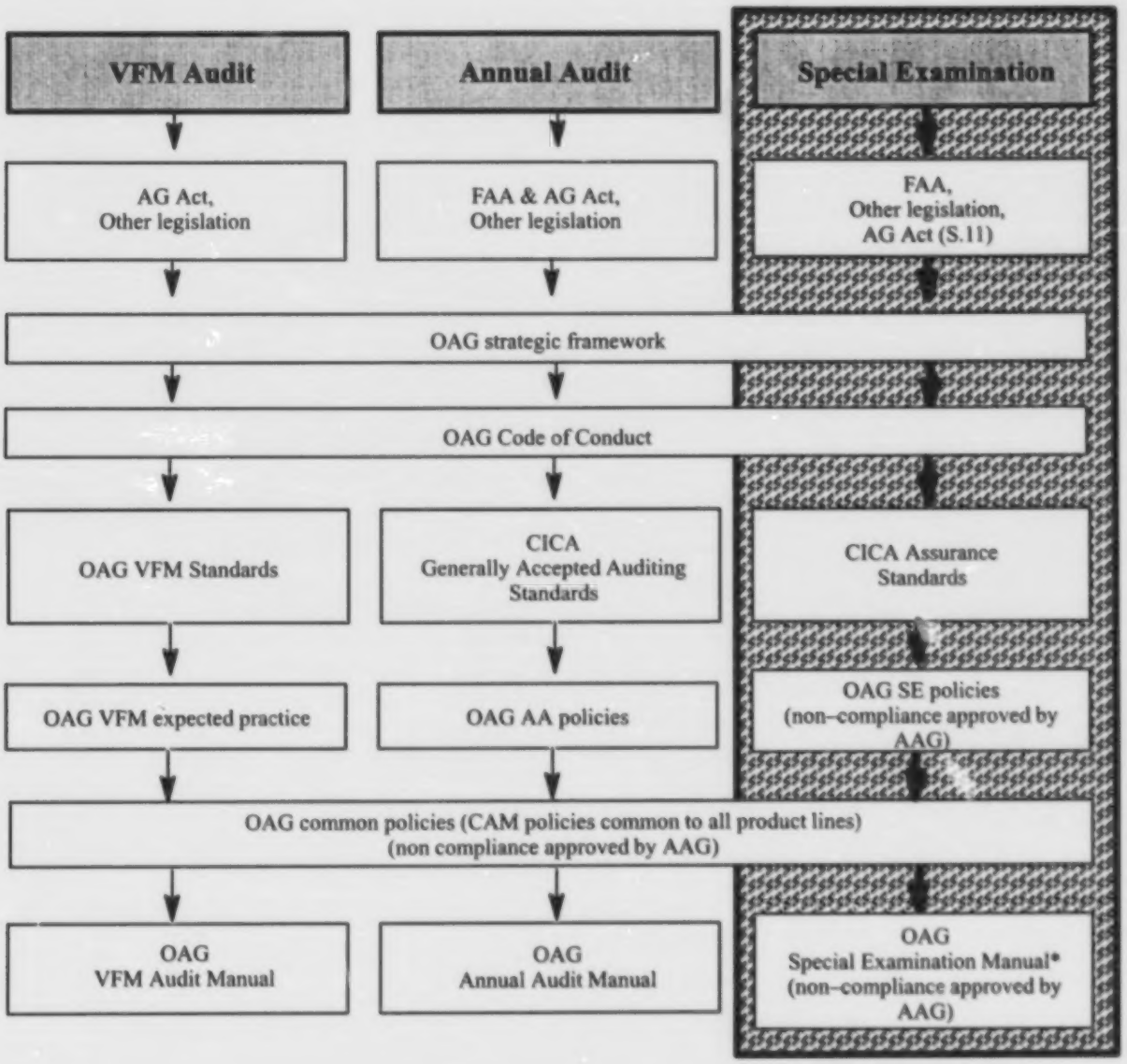
- the use of the "standard" approved templates for the SE plan, the SE report and the RCM; and
- the following critical examination judgment areas:
  - understanding the business;
  - identifying the corporation's expected corporate results;
  - identifying the major risks related to the expected corporate results;
  - identifying the key areas (systems and practices) for in–depth examination;
  - developing suitable results–oriented criteria; and
  - evaluating and reporting deficiencies (including defining the problem and determining its cause and impact).

Financial Administration Act (FAA)

80. The following key sections of Part X of the FAA are relevant for special examinations:

- Exempt Crown corporations – s.85
- Systems and practices to be maintained by Crown corporation – s.131
- Corporate plan and budget requirements – ss.122 to 125
- Annual report requirements – s.150

Exhibit 9



- Internal Audit requirement and reliance – ss.131(3), 138(5)
- Appointment of examiner – s.142
- Right to information – s.144
- Initiation of special exam and timing – s.138(1, 2)
- Special exam plan and criteria to audit committee – s.138(3, 4)
- Special exam report to the board, minister and Parliament – ss.139 to 141
- Restriction of examiner's opinion – matters of policy – s.145

Canadian Institute of Chartered Accountants (CICA) – Standards for Assurance Engagements (Section 5025)

- reasonable basis for believing the engagement can be completed in accordance with standards
- management's acknowledgment of responsibility
- due care and an objective state of mind
- adequate proficiency
- adequate collective knowledge of the subject matter
- ability to identify or develop criteria that are suitable and use them in forming conclusions
- adequate work plans and proper supervision
- concept of significance
- sufficient appropriate evidence and documentation to support conclusions
- reporting standards

81. Other relevant sections include:

- s.5050: Using the work of internal audit
- s.PS 5400: Value–for–money auditing in the public sector
- s.PS 6410: Planning value–for–money audits in the public sector
- s.PS 6420: Knowledge of the audit entity in planning value–for–money audits
- s.PS 6430: Engaging and using specialists in value–for–money audits in the public sector

Planning the Special Examination

Policies for Planning the Special Examination

82. All Office practitioners must comply with the expectations set out in the legislation pertaining to individual product lines, the OAG Strategic Framework, the OAG Code of Professional Conduct, and CICA Auditing Standards. The policies outlined below define practice expectations that complement or elaborate upon these requirements.

General Policies
• Office practitioners should comply with CICA standards for assurance engagements, special examination policies, CAM common policies, and OAG special examination methodology, Any deviation should be approved by the examination Principal and the responsible Assistant Auditor General (AAG). • Where necessary, the Office should obtain the authority to undertake the special examination. Such authority would include an order in council under section 11 of the *Auditor General Act* for exempt Crown corporations, or an order in council under subsection 142(2) of the FAA where only one of the two joint auditors is to be the examiner. • Where the Office is involved in a joint special examination, the examination team should ensure that the work performed by the joint examiner is sufficient and appropriate to support the joint report. • As part of ongoing knowledge of the corporation, the entity team should be aware of the corporation's actions in response to significant deficiencies reported in past examinations. • Timely feedback should be sought from Crown corporation boards of directors and senior management on the special examination process and results. • Examination teams should collectively possess sufficient knowledge of the corporation's business and the industry in which it operates to ensure an efficient and effective examination with a focus on significance and a results orientation.
Policies Related to Consultation

• The advisory committee (internal and external specialists and senior Office staff), the appropriate functional responsibility leaders (FRLs) and the second reviewer should be consulted when the issues are unusual, complex, controversial, or require specialized knowledge or experience. At a minimum, the examination team should obtain input at the following critical times:
  ◦ Planning phase: when discussing expected corporate results, risks, key areas and examination criteria, and when drafting the examination plan;
  ◦ Conducting and reporting phases: when discussing significance of deficiencies and reporting strategies, and when drafting the long–form special examination report.
• The examination team should keep the corporation informed about the existence and resolution of any sensitive examination issues.

Policies Related to the Planning Phase
• The examination principal should be actively involved in all critical strategic planning decisions, including identification of expected corporate results, evaluation of risks, identification of key areas for detailed examination, and development of results–oriented criteria. These critical audit judgments should be adequately documented and reviewed by the AAG. • While the examination opinion covers the corporation as a whole, the examination should focus on key areas critical to the achievement of expected corporate results, identified through a risk analysis. • Criteria should have a results orientation, thereby identifying, where appropriate, the results to be achieved by the corporation's systems and practices.

4 The Planning Phase and Results Orientation

Planning Phase

83. The key steps in planning a special examination are:

- acquiring sufficient knowledge of the entity and an understanding of its mandate, objectives, expected results, organization and operating environment – through interviews, review of key documents and consulting with stakeholders, board members and corporate management (discussed in Chapter 5);
- identifying the corporation's expected corporate results (ECRs), key risks/events and key areas (or systems and practices) for in–depth examination (discussed in Chapter 6);
- selecting general criteria (discussed in Chapter 7);
- determining reliance on internal audit;
- preparing the draft special examination plan; and
- scheduling an OAG advisory committee meeting to obtain advice on the draft special examination plan.

84. **Reliance on internal audit.** Subsection 138(5) of the FAA requires an examiner to rely on any internal audit of the corporation to the extent considered practicable. In the planning phase, the examiner obtains an overall view of internal audit to establish the general prospects for reliance and to identify specific internal audit projects that are relevant to the special examination and have the potential to provide necessary evidence. The examiner should conduct a preliminary review of the scope, design, focus and criteria of the chosen internal audits to determine whether they actually do address the issues that are relevant to the special examination. The examination plan would describe the overall plan for reliance and the extent and scope of reliance contemplated for each examination project.

85. Section 5050 of the CICA Manual requires the practitioner to assess the internal audit function if he/she plans to use their work. The practitioner would normally consider the following factors: organizational status, scope of the function, knowledge and competence, and due care (evaluating internal audit projects is discussed briefly in Chapter 8).

86. For some smaller organizations, an exemption from internal audits may be granted by order–in–council if the costs of such audits are considered to outweigh the benefits.

87. Where there is a lack of compliance with FAA internal audit requirements (and no exemption was obtained), the examiner would consider reporting this matter in the annual auditor's report, in a management letter or in the special examination report.

88. **Draft special examination plan.** One of the main purposes of the plan is to highlight the intended areas of focus and the reasons these areas were selected. The plan serves various audiences:

- the corporation – the plan allows board members and senior management to understand what examiners will look at and why, and provides an opportunity to comment on the appropriateness of its contents, including the criteria.
- internal and external advisors – the plan provides an opportunity for advisors to comment on the appropriateness of environmental factors identified, key areas selected for in–depth examination, criteria and results–orientation focus.
- the special examination team – the plan helps the team to focus and agree on the corporation's key areas based on a results–oriented approach.

89. The plan should be written in a practical, non–theoretical style.

90. Advisory Committees. Special examination advisory committees are an essential component of the Office's special examination quality management system. Committee members are consulted at least twice and sometimes more often for the larger special examinations. They are consulted at the end of the survey, to provide advice on the draft examination plan, including proposed expected corporate results, risks, key areas and general criteria. They meet again at the end of the conducting phase to provide advice on the draft examination report and proposed findings, on significant deficiencies and possibly on reporting strategy. The selection process for advisors will usually involve consultation of the Crown corporation.

91. The use of advisory committees is not a legislative requirement, but reflects the Office's interest in ensuring that appropriate skills and experience are brought to each examination. Furthermore, the advisory committee helps to ensure that the examination is of the right quality, is focussed on relevant issues and contributes to adding value to the corporation.

92. The advisory committee is designed to provide a forum in which the examination team can present its plans and preliminary conclusions, and can discuss contentious issues and reporting strategies. The advisory committee advises the AAG, the examination principal and the examination team.

93. Committee members will generally be asked to comment on:

- the team's assessment of the corporation's environment;
- the expected corporate results and identified risks;
- the key systems and practices (key areas) selected for in–depth examination;
- the criteria selected;
- the conclusions reached based on the evidence provided;
- the reporting strategy in relation to the deficiencies identified; and
- other questions arising from the examination.

94. Most advisory committees are composed of the chairperson, two or more representatives from outside the Office, and two or three others from inside the Office. Membership on the committee is based on the potential contribution of individuals to a specific examination, given their insights, skills, knowledge and experience. The responsible AAG acts as chairperson, and the other internal members often include the AG or the DAG, the second reviewer (Principal or AAG) and other appropriate functional advisors.

95. Reference. For a more extensive treatment of the role of Advisory Committees, see the OAG publication General Information on Special Examinations for External Advisors.

Results Orientation

96. In carrying out a special examination, the examiner should use a results orientation. Thus, in order to select areas for examination that will lead to an opinion respecting the achievement of the statutory control objectives, the examiner must clearly understand what the corporation must achieve or do very well to be considered a success.

97. Practising the following results–orientation techniques will assist in providing a results–oriented special examination:

- Acquire a good understanding of the corporation's business, focussing particularly on:
  - identifying what the corporation must do well to be successful (leads to identification of expected corporate results);
  - identifying the significant events that would prevent the corporation from being successful (consists of identifying potential events, assessing risks in terms of magnitude and likelihood, and retaining only those risk areas judged to be significant (having medium to high risk); and
  - identifying the key areas (systems and practices) that would enable the corporation to manage identified risks.
  - Formulate general criteria that state what is necessary to achieve what specific results, rather than how key areas (systems and practices) should be structured. In other words, criteria should not only focus on processes, but should also include intended results.
  - Always consider the perspective of the board and senior management: determine what they need to make key decisions or to be successful.
  - Focus on those key areas (systems and practices) that are critical to achieving expected corporate results. If an area is judged to have little potential impact on any expected corporate result, it is not a key area and should not be identified for in–depth examination.
  - Use performance indicators to help identify key areas for examination.

5 *Understanding the Business and Corporate Governance*

Introduction

98. From the outset the examiner must focus on the opinion to be rendered on completion of the special examination – the provision of positive assurance as to whether there are any significant deficiencies jeopardizing the achievement of the statutory control objectives.

99. By having a thorough understanding of the business and its corporate governance, the examiner learns of its successes and failures, its business environment and the challenges and opportunities it faces. The examiner constantly conveys and communicates the quality of this understanding in a number of ways, for example, through the special examination plan given to the board and to members of the advisory committee and through memos, briefings, and discussions with senior management, client staff and the examination team. Knowledge of the business is a cornerstone of the examiner's and, consequently, the Office's credibility.

100. To arrive at an opinion, the examination team must start with a good knowledge of the corporation's business and management methods, so as to be able to build a results–focussed examination plan. This entails obtaining an understanding of what the corporation sets out to do, how it structures itself to do it, and how it manages the risks to achieving its desired results.

101. Because of the results–focussed orientation, the examiner requires a clear understanding of what the corporation must achieve to be considered a success, (that is, what its expected corporate results are and what risks are to be managed or mitigated so that the results are optimized. Identifying and analyzing these critical success factors is crucial to a successful special examination and is a major challenge that requires understanding of the corporation's mandate, mission, objectives and strategies.

102. This knowledge assists the examiner in making informed decisions when selecting aspects of the corporation for in–depth examination. It also provides the essential backdrop against which suitable criteria are selected and professional judgments are made.

103. This chapter sets out a suggested framework for collecting and analyzing information about the corporation. It looks at the organization as an integrated whole and focusses on results to be achieved and risks to be managed. Such a framework, or model, is helpful in selecting, gathering, documenting and interpreting relevant information about the corporation, its operations and governance structure.

104. Using this framework, the examiner arrives at preliminary conclusions regarding the extent to which the corporation is achieving expected results. The identification and preliminary assessment of key results is based on an understanding of the following factors:

Strategic planning and management

- the corporation's mandate (including its public policy role), mission, objectives, goals and strategies
- the corporation's environment: business sector and competitors, social and economic conditions, political factors, government policies, relationship with government and other stakeholders, technology, globalization, demographics and geography
- corporate governance
- risk management
- measurement and reporting of the corporation's performance
- internal audit

Organization and culture

- organizational structure
- decision–making environment: assigned authority and responsibility within the corporation
- management's philosophy and operating style
- openness, communication and interaction/collaboration within the corporation (between head office and regions and among corporate departments)
- corporate culture, values and ethics

Operations

- production, management and delivery of products and/or services
- productivity, efficiency and level of service
- research and development
- marketing and sales
- revenue generation

Resource management

- human resources
- financial resources
- physical resources (including capital assets, facilities management and inventory management)
- management information systems
- support services
- safety, security and environment

105. Some of these factors are developed more fully in the following sections.

Understanding the Corporation's Mandat, Mission and Objectives

106. Mandate. The mandate of a Crown corporation is usually set out in its enabling legislation or articles of incorporation. The examiner should determine whether there

have been any changes to the mandate or enabling legislation since the last special examination. In some cases, the government may have given direction to the corporation – through other legislation, through a regulation, Order in Council, Treasury Board decision or directive, or in a more informal way – as to how it should pursue its objectives. Such direction may impose important obligations on management. The mandates of Crown corporations are often stated in broad terms that are difficult to measure (for example, "improving housing standards" or "enhancing the competitiveness of Canadian products").

107. Mission. Mission statements usually indicate the desired general direction of an entity without having any specific targets or dates. The corporation's management must translate such broad statements into corporate objectives with appropriate strategies to accomplish the desired ends. Top management assesses the external environmental threats and opportunities and the internal organizational strengths and weakness. Armed with these assessments, management defines a strategic direction that identifies how the **corporation intends to accomplish its mandate.**

108. Objectives. The mission and strategic direction need to be translated into more specific objectives with clearly defined, measurable targets and deadlines. These parameters allow management to monitor progress toward achievement of the longer–term strategic objectives. To the extent possible, objectives should be results–oriented, rather than activity–oriented. An activity–oriented objective is stated in terms of actions the corporation plans to undertake (for example, "initiate new programs") on the premise that results will be improved. A results–oriented objective sets specific targets for key performance indicators (that is, measures that clearly and unambiguously indicate how management demonstrates whether the corporation is achieving its objectives – its desired results).

109. Corporate plan. The mandate, mission and objectives often require explanation and amplification through a review of other government and corporate documents (such as annual reports, operating plans, directives and policies) and management interviews. The corporate plan is an important additional source of information because it sets out the government–approved objectives of the corporation. The FAA requires that the corporate plan include a statement of "the objects or purposes for which the corporation is incorporated, or other restrictions on the business or activities that it may carry on, as set out its charter." It also requires a statement of "the corporation's objectives for the period to which the plan relates and, for each year in that period, the strategy that the corporate strategy intends to employ to achieve these objectives."

110. Building upon the FAA requirements, Treasury Board has issued guidelines to Crown corporations for the preparation of corporate plans, including content requirements. It should be noted that the corporate plan has been prepared to communicate certain messages to the minister, the government and the public through its summary. Internal operating objectives will generally be more comprehensive and specific than corporate plan objectives.

111. In short, the corporate plan may be a key source of useful general information and should be reviewed; it too, however, will generally need to be supplemented by other sources. As a corporate plan may contain information that could be commercially detrimental if made public, it is essential that care be taken to ensure its confidentiality and control.

112. Public policy objectives. Some objectives, particularly those of a public policy nature, may be more difficult to express in terms of targets. However, if the corporation does not state its objectives in a measurable way, it will not know whether they are being realized. Furthermore, if the corporation does not attempt to measure results of an objective, its seriousness about the objective appears questionable.

113. Crown corporations represent, in varying degrees, a mix of public policy and commercial goals. Sometimes, performance is not easily evaluated because of the tension, if not conflict, between almost inevitably competing goals. Adequate yardsticks can be difficult to find in such situations. Achieving social or public policy goals may be at the expense of financial or commercial performance, and the balance between the two may shift over time in response to changes in the external or internal environment. Understanding the nature of this potentially difficult balancing act is essential for the examiner, because it goes to the core of effective management of the corporation. Thus, the examiner must have a thorough knowledge of the corporation's business.

114. Although not authorized to express any opinion on the "merits of matters of policy, including the merits of the objects or purposes for which the corporation is incorporated (FAA, s.145)", the examiner should analyze these objects and purposes in order to understand how well the corporation has defined where it wants to go and how it is going to get there.

115. The examiner needs to understand the corporation's commercial and public policy objectives in terms of clarity, measurability, consistency with its mandate, responsiveness to its external environment, and reasonableness given available resources. The examiner thereby identifies those matters that the corporation must do well if it is to succeed (that is, safeguard assets, manage resources economically and efficiently and carry out operations effectively). If the objectives are wanting, it is likely that the examiner may conclude that the corporation will not be able to determine if it is effective.

Understanding the Corporation's Operating Environment

116. Understanding how a corporation and its environment interact is essential to determining what activities need to be carried out in order for the corporation to minimize risks and achieve its objectives. **Exhibit 11** outlines some external and internal events that may result in threats to Crown corporations.

117. The external environment includes factors over which management has limited control, such as government policies, customer demand, availability of resources, competitors and special interest groups. The external environment is therefore a major source of risk to the corporation. This is true regardless of whether or not such risk is controllable. External matters affect planning, program delivery, management controls and performance information, and changes initiated as a result of these factors are a response to risk. For the purpose of information collection and analysis for the special examination, the external environment is considered under three major categories: the business sector, social and economic conditions, and political factors (also refer to **Exhibit 10**).

Exhibit 10

Potential Threats to Crown Corporations

External Events

- Changing economic conditions could affect the demand for a corporation's goods and services and its ability to raise funding or obtain required resources.
- New competition could alter marketing and service activities.
- New regulations or legislation could force changes in operating policies and strategies.
- Technological developments could dictate new ways of carrying out activities.
- Demographic changes, such as the ageing population, could affect demand for the corporation's products and the availability of essential skills.
- Pressure for results may affect investment in new technology, plant and equipment.
- Political sensitivities may influence risk–taking and innovation.
- Government policies may affect the corporation's employment of labour.

Internal Events

- Unrealistic, inconsistent or unclear objectives may cause inefficiency and ineffectiveness .
- The quality of personnel hired and methods of training and motivation can greatly influence a corporation's effectiveness.
- A change in management responsibilities or a disruption in information systems can adversely impact operations.
- Low spending on research and development can hamper long–term competitiveness.
- Lapses in safety or security procedures or breakdowns in quality control may cause direct financial loss, and will usually have more far–reaching consequences in terms of the organization's reputation.

118. The business sector. Some Crown corporations offer products or services similar to those of private– sector businesses; some may be competing in international markets; others may be more like government departments than commercially driven business organizations. The examiner needs to understand the nature of the business sector (or sectors) in which the corporation operates, and the strengths and weaknesses of the corporation compared to others in similar businesses. Similarities, may provide a source of useful general comparison, benchmarks or input to performance indicators. A knowledge of the sector will help to identify those issues and risks that may affect the corporation.

119. Social and economic conditions. The examiner should consider the extent to which the corporation is affected by changes in social and economic conditions, such as ageing population, changes in interest rates, or increasing ecological concerns and responsibilities. These factors can, depending on the nature of the business conducted by the corporation, have a profound impact on how programs are developed and delivered to customers. The continued relevance of programs is partly dependent on management's

ability to react to changes in social and economic conditions. Such factors can affect the demand for the corporation's goods and services, the availability of key resources such as capital or skilled labour, and the way it provides its products.

120. Political factors. All Crown corporations are influenced by the political environment. They are created and given their mandate by Parliament; they get equity from the government, and many require government operating funds. All Crown corporations are expected to comply or act in accordance with government policies such as wage restraint, employment equity and official languages. Some may be affected by new and shifting policy initiatives of other levels of government. The nature and extent of the corporation's regular interaction with governments, at the federal, provincial and municipal levels, will vary greatly. The examiner should understand how the corporation's relationship with government is sustained and managed, and the extent of government's impact, on business operations, record– keeping and reporting mechanisms. In short, the examiner needs to understand the effect of government initiatives and other government programs on the corporation.

Understanding the Corporation's Decision–Making Environment and Corporate Governance

121. Getting things done in any corporation is a complex matter that goes beyond organization charts, policy and procedure manuals, committees and even key executives. The examiner needs a broad knowledge of how things are made to happen in the corporation, and how it is organized to achieve its objectives. While this can be done by assessing the resources and activities necessary to generate the goods and services produced and by identifying the planning and control systems that ensure co–ordination of these activities, it may be necessary to go further.

122. The examiner should also seek information on the nature and sources of power, on where it resides in the organization, how it influences strategic decision making and who has sway over decisions. Put another way, the examiner should know the corporation's "control environment". This means understanding management's philosophy and operating style – how it assigns authority and responsibility, how it organizes and develops its people, and what role the board of directors plays.

123. The way the different parts of the organization communicate and interact with each other should be explored because it has a profound effect on the character of the organization as a whole. Each division must clearly understand what its duties and responsibilities are and how its activities relate to the work of other divisions. Management and the board need to obtain the appropriate information to allow them to fulfil their responsibilities. The corporation must have methods of capturing, analyzing and reporting information so as to ensure that the right facts reach the right people.

124. To gain insight into the organization, the examiner should consider corporate culture and values, although they are highly subjective and difficult to evaluate. A knowledge, not an audit, of this area is what is being sought. The corporation's values, culture and philosophy are greatly influenced by the personal values of the key decision makers and are reflected in the mission and strategy, the management style and the organizational structure. The human resource management system shapes and reinforces the corporate culture through the selection, training and development of individuals.

125. Governance. Governance is important and might be linked to significant deficiencies, directly or indirectly. However, if one takes a results orientation in the special examination, only a general knowledge of governance may be required, and would be obtained at the preliminary survey stage. This is because the cause–effect link between good corporate governance and good performance may not be clear. If, during

the preliminary survey, the examiner had detected governance problems, then the risks to the corporation as a whole would likely increase, and there might be a need to examine more areas in greater depth to ensure that results are being achieved. If results are not being achieved, a significant deficiency would likely be reported and could be linked to a governance problem. However, since governance is essentially a board issue anyway, and the report is provided to the board, it might not be necessary to determine who is responsible for the deficiency. Also, in such cases, it is difficult and probably speculative to attribute cause to any one party along the accountability chain. **Exhibit 11** suggests some key questions for obtaining some insight into the state of governance in the corporation. For a more extensive discussion of corporate governance in the present context, see Appendix 2, Corporate Governance Considerations in a Special Examination.

Exhibit 11

Corporate Governance – Key Questions

1. **Functioning of the board**
   Does the board of directors meet its corporate governance responsibilities, and do its procedures and practices function to assist the board and its individual members?

2. **Working with senior management**
   Has the board of directors developed a working relationship with the CEO that enhances the board's effectiveness in overseeing management and at the same time allows the board to function with a perspective independent of that of management?

3. **Accountability of the CEO**
   Does the board evaluate the CEO's performance against the established duties and objectives agreed to by the board and the CEO at the start of each year, to ensure that the CEO achieves performance expectations and deals with any performance deficiencies?

4. **Information**
   Does the board receive the information necessary to perform its work?

5. **Reporting**
   Does the board ensure that the corporation's external reports reliably communicate, in a timely and comprehensive manner, all the information about the significant issues confronting the corporation, its performance, its financial viability, and its ability to fulfil its mandate?

6. **Assurance**
   Does the board have assurance about the integrity of corporate information and of the corporation's internal control systems?

7. **Relationship with the minister**
   Does the board of directors ensure that it has a mutual understanding with the minister concerning the corporation's performance, planned strategies and objectives, and major issues confronting it?

Exhibit 11 (cont'd)

8. Values and ethics
Has the board ensured that appropriate values and ethics have been institutionalized into the corporate culture to help guide the behaviour of employees?

9. Public policy
Does the board understand the corporation's public policy objectives, and does it ensure the appropriateness of the balancing of these public policy objectives with the corporation's commercial objectives? Does the board periodically ensure the continuing relevance of the legislated mandate?

Understanding the Corporation's Operations

126. The examiner analyzes business operations in depth so as to clearly understand the area under review and ultimately the corporation as a whole. The examiner asks these questions:

- Are there issues here that should concern me?
- How much work may I have to do here?
- What are the data saying to me?
- Should this area be considered for in-depth examination?

127. Performance Information. Performance measurement is central to good management and helps to fulfil accountability needs. Obtaining performance information is part of gaining an understanding of the business, and is an active data-gathering exercise.

128. Performance indicators become meaningful only when compared to other indicators, either internally (with targets or a series of similar indicators of the same company over a period), or externally (with comparable indicators of similar businesses or with industry averages or standards). In some cases, making external comparisons may be difficult or should be done cautiously, since Crown corporations are generally created to carry out activities that are not available in the private sector.

129. When making external comparisons, it is important to keep in mind the special characteristics of Crown corporations, and the fact that each one is unique. For example, profitability ratios may have limited value because, although many Crown corporations are expected to be self-sustaining, profit maximization is not always an objective.

130. However, some aspects of Crown corporation operations may have similar (if not identical) counterparts in the public or private sector in Canada or in other jurisdictions. For example, corporations that maintain vehicle fleets may have management issues similar to those of other large fleet operations.

131. In meetings with the corporation's management, the examiner should discuss and substantiate significant trends and fluctuations in both financial and operational performance. Note, however, that simply because a corporation has achieved acceptable results, this is not sufficient reason to conclude that its systems and practices provide the required level of assurance. To do so would be to ignore the elements of chance and timing. Only after the examination phase reveals that systems and practices exist and are working can the examiner derive reasonable assurance based on desired results.

132. Reference. Further information on performance indicators as related to Crown corporations will be found in the *Report of the Auditor General*, December 1997, Chapter 22, Crown Corporations: Making Performance Measurement Work. This chapter reports on an OAG study aimed at encouraging further development and greater use of meaningful performance measurement and reporting in Crown corporations.

Sources of Information

133. In most cases, the Office has accumulated a substantial amount of information about the corporation through previous special examinations, annual audits, corporate plans and annual reports.

134. A reasonable and efficient starting point would be to review all information on the organization contained in previous special examination plans or reports. However, it is likely that the organization and its operating environment would have since changed considerably. Determining what has changed and why, as well as what further changes may occur during the course of the special examination, should also be part of the initial inquiries.

135. General Sources. The following paragraphs provide the examiner with general guidance on sources and approaches to gathering basic facts. This is not intended as an exhaustive list of sources but, rather, as a starting point.

- **Interviews with board members, senior management and employees.** Interviewing selected personnel is vital during this phase. This is an effective way of quickly grasping the essence of the corporation, its external environment, its strategic and operational objectives, its critical success factors and its systems and practices.
- **Review of key client documents.** Enabling and other relevant legislation, and the corporation's recent corporate plans, annual reports, board minutes and senior committee minutes are also sources of information.
- **Visits to regional offices or operating plants.** Where the corporation operates from multiple sites to manufacture or deliver products or services, it may be useful to visit a selection of these sites.
- **Performance information.** Looking at financial and operational performance information enables the examiner to understand which factors influence results, as well as to identify potential problem areas.
- **Discussions with stakeholders.** Crown corporations interact with their appropriate Minister and department, with central agencies, with other government departments as well as with customers. All of these may be rich sources of information for the examiner and, subject to confidentiality of client information, should be considered as possible ways to enhance understanding of the corporation's business.
- **Discussions with industry experts.** Experts can include industry analysts, consultants, academics and retired members of senior management in similar enterprises in Canada and elsewhere. Provided they are credible, respected experts in fields judged relevant, such sources can be a useful and economical source of information, especially on questions relating to business trends, performance measures and critical success factors.
- **External or internal studies, benchmarks, reviews or audits.** These sources include reports and papers published by relevant industry professional bodies or trade associations; studies done by consultants on behalf of the corporation;

external and internal audits of the corporation, its divisions or functional areas; previous special examination reports and management letters; and benchmarking studies.

- **Consultation of staff having worked on previous financial audits.** Annual financial audits provide an important source of knowledge and information.

Understanding the Business – Summary

136. This phase of understanding the business, as so far described, is essentially an information–gathering and analytical activity exercised through techniques involving personal interviews, assembling of data garnered from internal and external documentary sources, and reviews of work by other auditors, consultants, independent agencies or the corporation itself. This is a preparation for the analytical phase, where the examiner should be able to identify with confidence the expected corporate results and risks so that an examination plan may be formulated to address key areas for in–depth examination.

6 *Using the Identification of Expected Corporate Results and Risk Analysis to Select Key Areas for In–Depth Examination*

Introduction

137. Gaining an understanding of the business is a process of document collection, review, analysis and discussion with corporate management and others. The analytical element increases over time, and is dominant as the examiner becomes able to identify the critical factors for the success of the business (that is, the expected corporate results) and the risks that jeopardize that success. In fact, the process of understanding the business and then identifying expected corporate results and risks blend into one, and the phases are separated here merely for clarification.

138. **Management models.** In business literature, there are many conceptual models describing organizations as systems of interacting parts. These may be useful to the examiner as an analytical device as long as they help to identify what systems and practices, or parts thereof, are in place to manage expected corporate results and risks. No two entities will, or should, have the same systems and practices; they will differ dramatically by industry, in size of organization, in corporate culture and in management philosophy. The examiner needs to consider how activities from different functions combine and are co–ordinated to produce results and manage risks.

139. **The Office's approach.** There are many ways to approach the identification of key systems and practices. For the purpose of conducting effective and efficient special examinations, the Office has chosen to use the expected corporate result / risk analysis model developed in this chapter.

140. Teams should clearly document their understanding of the results that the corporations need to achieve to be successful, and the threats to their achievement. Teams can then discuss these matters within the Office, with corporate management and with the audit committee of the board to ensure that all have a common understanding of results and risks.

141. In order to ensure that results/risks are reflected in the examination approach, there should be a link from the results upward to the corporate mandate and objectives and downward to areas selected for examination and to criteria.

Expected corporate results (ECR)s

142. After gathering and analyzing information on the corporation's mandate and objectives, external environment, operations and corporate governance, the examiner must identify and consider the key mid– to long–term results that the corporation must achieve to be successful. With this knowledge, a risk analysis is done to determine the significant risks to the achievement of those expected corporate results and, consequently, the areas that need to be managed well to minimize those risks.

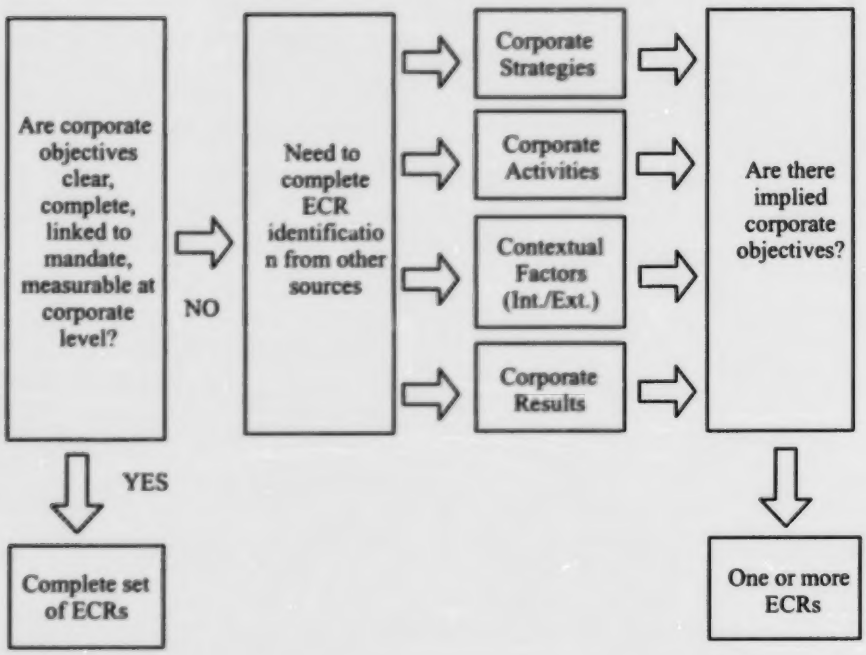
143. In determining the expected corporate results, the examiner must maintain the "view from the top", that is, he/she must identify the half–dozen or so critical results that

senior management monitors, or should monitor, to ensure that the corporation is on track. As most Crown corporations have both a commercial and a public policy aspect to their expected performance, both should be considered.

144. **Exhibit 12** is a model of the expected corporate results identification process, showing, in a simple decision tree, how the examiner proceeds. In situations where the expected corporate results are not clearly identified by the corporation the examiner must define them from the various sources
suggested.

Exhibit 12

Expected Corporate Results (ECR) Identification Model


Are corporate objectives clear, complete, linked to mandate, measurable at corporate level?
NO
YES
Complete set of ECRs
Need to complete ECR identification from other sources
Corporate Strategies
Corporate Activities
Contextual Factors (Int./Ext.)
Corporate Results
Are there implied corporate objectives?
One or more ECRs

The Nature of Systems and Practices

145. **Nature**. In the context of the special examination, systems and practices are those activities that focus on the achievement of desired results and on actions taken to mitigate risk. "System" is defined, in part, as "any cohesive collection of elements that are dynamically related to achieve a purpose." "Practice" is defined, in part, as "habitual action, method of ... procedure ... custom." For example, systems might include the preparation of periodic reports for management and the board. Practices might include weekly management meetings where no formal reports are presented but important information is exchanged.

146. It is conventional to view systems and practices as individual functions. Thus, managers talk about the accounting systems, the quality control systems, a human resource system, the system of internal control, and so on. Practice may often be seen as a disconnected series of habitual activities variously qualified as good, sound, preferred,

and so on. But, systems and practices should be viewed collectively, as portions of them may be combined across functional and organizational lines.

147. Generally, "systems" are formally approved procedures, while "practices" are what is actually being done. Although the two terms are mostly used together, they are not synonymous.

148. Areas. From the perspective of the examiner, systems and practices are viewed from the top – from the perspective of the board and senior management. Because the examiner is focussed on expected corporate results and risks, it may be useful to cluster systems and practices as they relate to expected corporate results and risks or even to groups of these. These clusters of systems and practices relating to expected corporate results and risks are referred to as "areas" in the special examination. Put simply, areas are ways of viewing systems and practices from the examiner's perspective. They may represent useful ways of packaging parts of the examination for audit project management purposes.

149. The expected corporate results and risk view point. The examiner needs to see the corporation's systems and practices from the perspective of their contribution to the achievement of results and the mitigation of risk. This viewpoint does not necessarily match with the traditional functional or organizational focus. The examiner may have to break down functionally oriented systems and practices and reassemble them around expected corporate results and risks to see how the relevant elements support the achievement of desired results. Therefore, for the purpose of the special examination, systems and practices have three distinguishing characteristics:

- they are very high–level and address the statutory control objectives;
- they exist as traditional views of functional activities and organizational lines, yet may be viewed as clusters related to expected corporate results and risks; and
- they are focussed on achieving expected corporate results and mitigating risk.

150. Keeping these characteristics in mind will help the examiner to ensure that appropriate systems and practices are selected for in–depth examination and that the Office's resources are efficiently deployed.

151. In–depth examination. The term "in–depth examination" has a particular meaning in special examinations. It does not refer to the extent of evidence required or the audit work performed. Rather, it refers to the greater scrutiny given to areas of greater risk. This is not a "scoping in" or "scoping out" decision as in other VFM audits, because according to the legislation the scope for the special examination is "all systems and practices" or the "whole" corporation. In other words, if an area is not selected for in–depth examination it is because although there may be a deficiency in that area, it is not considered a significant deficiency, that is, one that would threaten the achievement of the statutory control objectives.

Risk Analysis and Key Area Selection

152. Definition of Risk. Risk and its definition have been a preoccupation of audit research and literature for many years. The Office defines risk as a "hazard, chance of bad consequences, loss or exposure to mischance." For the special examination, risk has two elements:

- the likelihood of an event occurring; and
- the magnitude or consequence of the impact should an event occur (this element carries more weight than "likelihood" in determining overall risk).

153. In striving to achieve the statutory control objectives, every Crown corporation faces the possibility of untoward events that could jeopardize the achievement of those objectives. External or internal events could increase costs, destroy assets, and threaten the corporation's financial strength, its positive public image or the overall quality of its products, services and people. In gaining an understanding of the business, the examiner will have determined the key results (called expected corporate results). This will likely have been done through the process suggested by the model shown in **Exhibit 12**. After determining these expected results, the examiner will know what the corporation must achieve to be successful and will have considered the external and internal factors that could influence that achievement. Next, the examiner will assess the risks to the achievement of the expected corporate results and determine the systems and practices critical to managing these key risks.

154. It is management's responsibility to identify, evaluate and monitor these risks, and to put in place systems and practices to manage them. Typically, risks are assessed formally as part of the planning process and informally on a regular basis.

155. The examiner must ensure that all important risks are identified, and must analyze and use the risks as a basis for selecting key systems and practices for in–depth examination. By so doing, the examiner can:

- focus the examination on areas where risks are most likely to impact upon the achievement of the expected corporate results and statutory control objectives; and
- use and apply available examination resources in a cost–effective and efficient manner and, where possible, add value for the corporation.

156. Because the special examination covers all of the corporation's systems and practices, it is doubly important that the examiner document risk analysis and key area selection. The rationale for selecting an area should be clearly expressed, and supported, as should the rationale for not selecting certain areas for in–depth examination.

157. **Risk analysis.** The risk analysis process applies to two types of risks:

- General risk, defined for purposes of the special examination as any event that could prevent the corporation from attaining its expected corporate results; and
- Inherent risk, defined for purposes of the special examination as the likelihood and consequences of the event occurring.

158. Additional comments on the nature and definition of risk for the special examination follow.

159. Risk analysis is, therefore, a two–step process:

- identifying possible events that, should they occur, would prevent the corporation from attaining its expected corporate results; and
- assessing the possible magnitude and likelihood of each event.

160. For those events where the inherent risk is judged to be sufficiently important (referred to as "key risk factors" or "key risks facing the corporation"), the examiner identifies "key areas". That is, the examiner establishes groupings or clusters of key systems and practices, which are then subjected to in–depth examination.

161. **Risk management.** Notwithstanding the difficulty of defining risk precisely, there is always risk involved in doing business: it can never be reduced to zero. Management's job is to determine how much risk should prudently be accepted in striving to achieve the corporate objectives, and to maintain that risk within an acceptable range.

162. Managers must determine the most effective way to manage risk, balancing the exposure against the cost of actions that might reduce it. For the manager, risk control means being aware of operational and environmental uncertainties and using mitigating strategies to reduce the negative impact on expected corporate results. In gaining an understanding of the risks that apply to the entity, it is essential that the examiner discuss risks, and the trade–offs that have been made in managing them, with corporate management.

163. It should be noted that risks are considered in relation to expected or intended results to be achieved. A key concept in applying risk management to special examinations in the planning phase is that when selecting areas for in–depth examination, only the inherent risk component is considered. This strategy is based on the view that those areas "scoped in" are those where there is a susceptibility to a particular threat, independent of the effect of controls. So where there is an area in the corporation with high inherent risk, that area would be subject to in–depth examination even if controls appear to be established and working. The degree and effect of controls, however, would influence the extent of audit work in the conducting phase.

164. This concept of inherent risk requires the examiner to couple both intrinsic likelihood and impact and to uncouple the possible mitigating effect of internal controls on risk. The examiner looks only at the risks AND their impact on the organization. Inherent risk is the basis upon which the examiner selects WHAT to examine. However, control risk and detection risk is not ignored completely. They are part of the basis for determining HOW MUCH and in WHAT MANNER to audit areas selected for in–depth examination.

Step–by–Step Approach to Risk Analysis

165. A step–by–step approach for connecting expected corporate results, risk, and statutory control objectives is summarized in **Exhibit 13** and is more fully developed below.

166. Step 1. For each expected corporate result (ECR) identified, determine the risks to its being realized (or events that would prevent its realization).

167. For each of the expected corporate results (or corporate objectives, if they are found to be the same), consider the threats – the potential adverse events that would undermine the achievement of the expected corporate results. Threats can arise from external factors, such as technological developments and economic changes affecting supply and demand, or from internal factors such as disruptions in information systems or changes in management responsibilities.

Exhibit 13

Summary

Step–by–Step Approach to Risk Analysis

1. For each ECR identified, determine the risks to its being realized (or events that would prevent its realization).
2. Evaluate the likelihood of the risks (events) occurring and assess their potential magnitude.
3. Rank the risks (events) according to their potential magnitude and likelihood of occurring (that is, their significance).
4. Identify the systems and practices associated with those risks (events) ranked medium to high, grouping them into key areas that address the ECRs.
5. Relate the identified key areas to the statutory control objectives.

168. Another approach to identifying risks is to consider what must happen for the corporation to achieve the

expected corporate results. For example, if being more cost–competitive is a key expected result, then two risks are lack of performance–based wage payment and low productivity If completing capital projects on time and within budget is a key result then risks are poor planning and control of projects and lack of experienced project managers.

169. In a rapidly changing business and government environment, failure to pursue new opportunities may be a major risk to the corporation's long–term success. Organizations need to be able to identify and respond to new opportunities, and should have systems and practices in place to do so.

170. Because each corporation is unique and faces a variety of circumstances, there is no ready–made checklist for determining expected corporate results and risks. The examiner will need to develop a list of risks affecting the particular corporation based on knowledge of the business. Discussions with management and the board concerning "what it takes for this corporation to be successful" and historical performance against objectives are useful sources of information.

171. Risk evaluation – entity–level view. Risk identification and evaluation is a subjective process that can best be carried out through a structured approach. It is critical that in the "scoping" stage the examiner consider risk at the entity level (not at the activity, program or functional level). Also, and as expressed elsewhere, level and identification is from the point of view of the CEO or the board. The multiple factors or views taken by the examiner in determining risks will allow an aggregation and a ranking of entity–level inherent risk as high, medium or low.

172. Step 2. Evaluate the likelihood of the risks (events) occurring and assess their potential magnitude.

173. Since corporations may face a range of risks, the examiner must limit the analysis to the most critical areas. This requires identifying possible events and making a subjective assessment of both their magnitude and their likelihood of occurring.

174. The examiner needs to consider the significance or consequences of things going wrong. What is the potential impact of a worst–case scenario? The concept of significance consists of qualitative and quantitative considerations. Impacts could be financial, such as loss of assets or increased costs. Even if the financial impact is small, a threat might be significant if it relates to areas of concern to the government or the public, as in the case of environmental damage or threats to public safety. Other types of impacts that could be considered are the loss of existing business or of new business opportunities and the alteration, destruction or misuse of sensitive or confidential information.

175. Magnitude. For some risks, it may be possible to estimate the cost of a loss. On the other hand, many potential threats defy quantification. At best, they can be described as high, medium or low. Although statistical techniques can be applied, in many cases good judgment and common sense are sufficient. Materiality is one aspect of magnitude. Although materiality may be used in planning special examinations, it would not necessarily be the prime consideration in selecting systems and practices for in–depth assessment. Explicit materiality limits are not normally included in the examination plan, because there could be problems reporting some findings as significant deficiencies if the effect is "immaterial" in quantitative terms, even though in qualitative terms the effect on the achievement of one or more statutory control objectives could be significant.

176. Likelihood. Assessing the likelihood that an event will occur involves determining a causal chain of events. The examiner needs to consider the susceptibility of the corporation to a particular risk and to assign a likelihood of high, medium or low.

177. Discussions with managers. Perceptions play an important role in weighing the magnitude and likelihood of risks. Different perceptions of the impact of a risk will lead

to different responses. The examiner should seek the views of a range of corporate managers on the impact of potential risks.

178. **Risk matrix.** The risk matrix (see **Exhibit 14**) is a model to assist in understanding the degree of risk. The higher the risk, the more reason to examine areas to minimize or manage it. Any risk falling into the black section of the matrix signals that some desired result may not be achieved and that areas affected should be subject to in–depth examination. Risks falling into the white section are low level, so in–depth examination of affected areas is probably not necessary. Risks falling into the grey section require further thought and professional judgment to decide whether affected areas should be examined in depth. However, it is likely that they would be included.

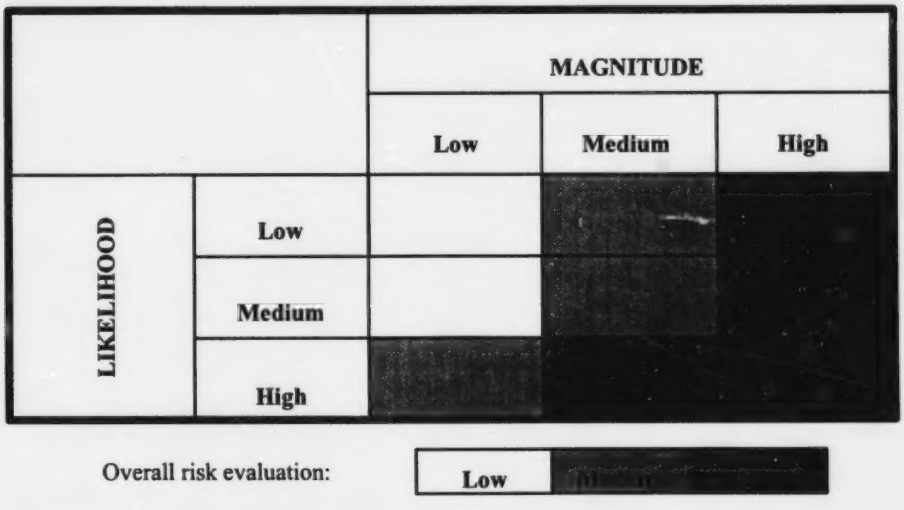
179. While both likelihood and magnitude affect the degree of risk, magnitude affects it more. That is, if magnitude is high (for example a plane crashing has terrible consequences) but likelihood is low (planes seldom crash), then risk is considered to be high, and those areas (in our example, areas influencing the incidence of pilot error and maintenance deficiencies) would be subject to in–depth examination. The extent of audit work on selected areas may be affected more by the likelihood component, as well as by control risk and detection risk – the lower the likelihood, the less audit work likely necessary. Fundamentally, the important component of the risk matrix, and the key concept being brought to the special examination, is the "magnitude/consequence" function: if the magnitude of an event is high, then the risk is high – even if the likelihood is low – and therefore it is subject to in–depth examination.

180. The risk matrix is not intended to be prescriptive, but rather to show that as likelihood and magnitude increase, so does risk. The examiner must consider this when determining the extent of risk and, therefore, the areas for in–depth examination. It is recognized that magnitude or consequence has a greater effect on risk determination, and it is also recognized that it may be difficult to determine likelihood, but in both instances, the analysis is a subjective assessment requiring expertise and judgment.

181. Not only does "likelihood" (as well as control risk and detection risk) play a role in determining the sample size or extent of audit of a particular area selected for in–depth examination, but it also plays a part in selecting systems and practices for in–depth examination.

Exhibit 14

Risk Matrix



182. Step 3. Rank the risks (events) according to their potential magnitude and likelihood of occurring (that is, their significance).

183. The examiner must focus on those risks with the greatest possible impacts and the highest probability of occurrence. A risk with a high likelihood that would result in a high loss if an event occurred is clearly a high risk. A risk with a low likelihood of occurrence that would not have a significant effect on the entity does not warrant serious concern. The circumstances in between call for difficult judgments. The "risk matrix" in **Exhibit 14**, sets out the thought process for analysis of risk.

184. To complete this step, the examiner ranks the risks in terms of their relative importance. He/she is then able to determine which risks are critical and must be managed and which can be prudently accepted.

185. Step 4. Identify the systems and practices, associated with those risks (events) ranked medium to high, grouping them into key areas that address the expected corporate results.

186. The examiner needs to determine what systems and practices are required to adequately manage risks that are critical to achieving the expected corporate results. This involves assessing whether there are actions that could be taken at a reasonable cost that would substantially lower the likelihood or impact of a negative event. Comparisons with similar organizations may be useful for gaining an understanding of "best practices".

187. Systems could be preventive procedures, such as physical inspections or specialized training or displacement procedures, such as hedging financial exposures or obtaining adequate insurance coverage. More controls are not always preferable to fewer: over–controlling is costly and cumbersome, restricts the use of judgment and constrains entrepreneurship. The focus should be on achieving an appropriate level of "control" (that is, an end) rather than adding a series of controls (that is, means to an end). In addition to control systems, the examiner should consider the planning and monitoring systems. Key desired results need to be clearly established and appropriate information made available to decision makers on a timely basis so that they can take corrective action as needed.

188. Step 5. Relate the identified key areas to the statutory control objectives.

189. Understanding the effects of key systems and practices on the achievement of the statutory control objectives and the interrelationships of systems and practices will make it much easier to assess and explain the significance of any deficiencies found during the examination.

190. Some systems and practices will not be identified as "key" and therefore, will not to be examined in depth. This does not mean that they have no deficiencies, but rather that any deficiencies that might exist would not have a significant effect on the achievement of the key results and, subsequently, on the statutory control objectives (that is, there would be no "significant deficiencies").

Other Considerations

191. Planning and communication. When assessing the adequacy of systems and practices to ensure the achievement of the statutory control objectives, it is particularly important to assess planning and communication. An organization cannot be effective if it does not have a clear idea of what it wants to accomplish and strategies for ensuring that the necessary actions take place. Objectives and strategies need to be communicated to those who must act to accomplish them, and managers must receive appropriate, accurate, timely information in order to direct and monitor operations, to be aware of relevant internal and external events and to identify and deal with risks.

192. The operational and support systems required by any given organization will depend on the key results it must accomplish and the associated risks. The risk assessment process is conducted to determine what systems and practices should be *present and functioning properly* to provide reasonable assurance that the statutory

Summary

193. The examiner selects key areas for in–depth examination by identifying inherent risk, then by considering control risk and detection risk. Inherent risk is determined by considering the likelihood of an event happening and the magnitude (or consequence) of its happening. This risk must be related to the achievement of expected corporate results. Comparing actual performance with indicators, is helpful in determining where the risks are, the possible extent of work required in the conducting phase, and the success or failure of the corporation in important areas.

7 Criteria Selection

Introduction

194. One of the characteristics of a special examination is that it involves reporting against criteria. As for other VFM audits, suitable criteria must be selected for special examinations because there are no generally accepted management principles. Criteria flow directly from the risk analysis. Key areas identified for in–depth examination are selected because of their importance to managing risks so as to achieve results. Criteria are explicit statements of what must be in place, in terms of system or practice, for a particular result to be achieved.

195. In the special examination report, the examiner must express an opinion on whether, with respect to the criteria established, there is reasonable assurance that there are no significant deficiencies in the systems and practices examined. It follows that any significant deficiencies reported must result from deviations from criteria. Therefore, selecting the right criteria is essential if the opinion is to provide the desired level of assurance.

196. In addition, the examination team should submit the criteria to be applied in the examination to the audit committee (or board of directors) of the corporation as part of a plan for the examination.

197. The underlying premise for the guidance offered in this section is that effectiveness is, in large part, a product of having systems and practices that promote achievement of expected corporate results, including the management of risks. Criteria, therefore, should provide standards against which the extent of the achievement of the expected corporate results may be measured.

The Nature of Special Examination Criteria

198. Criteria drive the evidence to be collected, as any deficiencies reported are in relation to them and because they are the basis upon which the opinion is formed. Therefore criteria should be suitable and should lend themselves to the audit process.

199. **"Criteria", for the purpose of the special examination, means examination criteria.** That is, criteria are those reasonable and attainable standards that, when related to the expected corporate results by the systems and practices examined, will enable the examiner to express an opinion as to whether management maintains systems and practices to provide reasonable assurance that the statutory control objectives are being achieved.

200. **Criteria should focus on results and not on process.** For example, where industrial safety is an expected corporate result for the corporation, employee safety training programs and physical protection systems should be in place that result in a safety record at least as good as the industry average. Further, in assessing how the safety program and the physical protection system are implemented, maintained or

administered, the examiner will want to determine the consequences of having them. The procedural characteristics of the systems and practices are of relatively less interest than the consequences or outcomes (results) of the systems and practices.

201. The intent is not to direct the evidence–gathering effort to lead to an opinion on a particular system or practice but, rather, to lead to an overall opinion on whether the statutory control objectives have been met by way of the systems and practices. Thus, the examiner will ultimately need to justify any potentially significant deficiencies (that is, instances where criteria have not been met) in terms of how one or more deficiencies in one or more systems or practices place the achievement of the statutory control objectives at risk.

202. For operational and support systems, criteria will depend on the circumstances of the particular corporation. These systems and practices should be adequate to ensure that action is taken to address the risks and ensure the achievement of key results.

203. **Characteristics. Exhibit 15,** provides characteristics of suitable criteria for special examinations. These characteristics may be helpful in forming criteria and assessing their suitability. The relative importance of the characteristics in different circumstances is a matter of judgment.

Level and Number of Criteria

204. **General criteria.** The criteria chosen for in–depth examination of selected key systems and practices should be relatively few and broad in their application, as the report of the examiner is on the corporation as a whole and is addressed to the board of directors.

205. Such key systems and practices are likely to be the main drivers for effectively managing the business – the critical success factors that need to be managed constantly to stay the course. They are the things that, should they show a sign of going wrong, are likely to keep senior management awake at night. In essence, these are the high–level criteria. Just as there are likely to be only five or six such matters, so are there likely to be only a few useful and properly articulated general criteria. They may be supported by sub–criteria.

206. General criteria may be a re–statement of desired results and what the corporation must do to achieve them, in the sense that they are the things that the corporation should achieve or should do very well to be deemed a success. A failure to meet a general criterion would likely result in a significant deficiency.

207. **Sub–criteria.** A sub–criterion is a more specific view of a general criterion. Sub–criteria should be suitable for auditing against, and should be supportive of general criteria. Whereas general criteria are usually high–level and form part of the special examination plan, sub–criteria should clarify the general criteria and assist in assessing selected systems and practices and the results they are designed to achieve. The use of sub–criteria should make the general criteria progressively more ascertainable. Like general criteria, sub–criteria are also focussed on results: they should indicate *what is required* to produce *what result*, or why the system or practice is needed in this circumstance. The number, nature and depth of sub–criteria are a matter of judgment. Generally, sub–criteria are not included in the special examination plan but may be made available if clarification of the general criteria is necessary.

Selecting Results–Oriented Criteria

208. Examiners may find that they can clarify the type and extent of evidence required by selecting a few high–level, results–oriented criteria that are directly linked to the risk analysis.

209. Risk analysis identifies the major risks that key systems and practices must address. The identified risks will serve to develop results–oriented criteria specific to the organization.

210. To be appropriate, results–oriented criteria must be couched in terms of cause and effect. Thus, the criteria must state the results that must be achieved by the systems or practices employed (that is, "what system, practice, characteristic or component" must produce "what result").

211. In thinking about criteria selection, the examiner should, based on the knowledge of the business, pose the following questions:

- What system or practice should be in place to achieve a key result?
- What ought to be the outcome(s) of employing the systems and practices so as to achieve the key results (that is, the corporate objectives)? The answer to this question will evolve into results–oriented general criteria.
- What are the key outcomes sought from the general criteria? The answers will be results–focussed sub–criteria.
- Will members of the board and senior management recognize the general and sub–criteria produced by this deductive process as addressing matters critical to the corporation's success?

212. To reduce the tendency to select "process–oriented" responses to those questions, each answer should be subjected to critical challenge until the examiner is satisfied that, as far as possible, practical and measurable general and sub–criteria have been selected that can be easily linked back to the overall expected corporate results and the statutory control objectives.

Sources of Criteria

213. Examiners are always looking for good sources of criteria. There are many sources within the Office, such as value–for–money audit guides, previous special examinations of Office corporations and other special examinations of similar organizations. However, using "off–the–shelf" criteria in a mechanical or uncritical way is discouraged, because by their very nature all examination criteria – especially general criteria – tend to be unique to a particular Crown corporation. They are imbedded in the business, the corporate culture and the external environment in which the corporation conducts its affairs. Therefore, all sources ought to be thought of as repositories of experience from which to draw new and original ideas and inspiration, rather than as templates to be reproduced.

214. However, if the process of understanding the business and carrying out a risk analysis is done rigorously, the criteria will be relatively easy to select. They will emerge as those outputs expected of the systems and practices to be examined (that is, what is required to provide an intended result or to minimize a particular risk to achieving that result).

215. **Special Examination Criteria Database.** ISES contains a database of generic selected criteria used in special examinations. They are grouped by functional area (for example, human resources, safety, strategic planning, financial management, operational performance). Notwithstanding the functional orientation presented for initial ease of reference, ISES offers the capability to use the database in many different ways. The criteria database is not a source of directly usable criteria. Rather, it is a prompter for the independent creation of largely unique criteria that bear directly upon the expected corporate results and risk characteristics of the entity under examination.

Changes in Criteria

216. Because general criteria must be presented to the audit committee as part of the examination plan, the examiner must bring any change in the plan, including changes to general criteria, to the committee's and management's attention.

217. As criteria will have been discussed with the advisory committee in the context of reviewing the special examination plan, it is expedient to discuss any changes in general criteria with the advisory committee before re–approaching the audit committee or the board of directors. Because of the high–level nature of general criteria and the process through which they are selected, changes to them are not likely to be trivial. For this reason and because of the need to maintain a professional relationship with the members of the audit committee and the board, it would be prudent to discuss the proposed changes in general criteria and their rationale.

Exhibit 15

Characteristics of Suitable Criteria

Relevance	Relevant criteria contribute to findings and conclusions that meet the objective of the engagement.
Reliability	Reliable criteria result in consistent conclusions when used by different practitioners in similar circumstances.
Neutrality	Neutral criteria are free from bias that would cause the practitioner's findings and conclusions to mislead intended users of his or her report.
Understandability	Understandable criteria are clearly stated and are not subject to significantly different interpretations by intended users.
Completeness	Complete criteria exist when all criteria that could affect the practitioner's conclusion are identified or developed, and used.

Source : CICA Standards for Assurance Engagements (S. 5025.39)

M121

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Conducting the Special Examination

Policies for Conducting the Special Examination

General Policies
• Office practitioners should comply with CICA standards for assurance engagements, special examination policies, CAM common policies, and OAG special examination methodology. Any deviation should be approved by the examination Principal and the responsible Assistant Auditor General (AAG). • Where the Office is involved in a joint special examination, the examination team should ensure that the work performed by the joint examiner is sufficient and appropriate to support the joint report. • As part of ongoing knowledge of the corporation, the entity team should be aware of the corporation's actions in response to significant deficiencies reported in past examinations. • Examination teams should collectively possess sufficient knowledge of the corporation's business and the industry in which it operates to ensure an efficient and effective examination with a focus on significance and a results orientation.
Policies Related to Consultation
• The advisory committee (internal and external specialists and senior Office staff), the appropriate functional responsibility leaders (FRLs) and the second reviewer should be consulted when the issues are unusual, complex, controversial, or require specialized knowledge or experience. At a minimum, the examination team should obtain input at the following critical times: • Planning phase: when discussing expected corporate results, risks, key areas and examination criteria, and when drafting the examination plan; • Conducting and reporting phases: when discussing significance of deficiencies and reporting strategies, and when drafting the long–form special examination report. • The examination team should keep the corporation informed about the existence and resolution of any sensitive examination issues.
Policies Related to the Conducting Phase
• The examination team should prepare detailed audit plans or programs, setting out the sub–criteria and/or audit procedures that will meet examination objectives and ensure that sufficient and appropriate audit evidence is obtained. The examination principal should approve these plans, and any significant changes thereto, before they are implemented. • The examination team should obtain sufficient and appropriate evidence to support its findings and its conclusions on the extent to which criteria are met.

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8 Conducting the Special Examination

Introduction

218. Generally, the conducting phase of a special examination starts after the examiner has submitted the examination plan to the audit committee. At that time, the examiner will have established expected corporate results and identified the key systems and practices, developed criteria and made a preliminary identification of potential deficiencies.

219. In the conducting phase, the objective is to gather sufficient, appropriate evidence to determine whether the criteria have been met. Where criteria have been met, the team discusses the findings with management. Where they have not, the team identifies the deficiencies and discusses them with management. In the reporting phase (see Chapter 9), the team assesses the significance of any deficiencies.

220. Evidence is required to enable an examination opinion to be given with an audit level of assurance. To provide an audit level of assurance, the auditor must seek evidence, including corroborating evidence from different sources and substantive testing, in order to weigh the findings against the criteria.

221. While special examinations are a form of VFM audit, the evidence requirements are different because of the nature of the opinion. Special examinations are positive–assurance, direct–reporting audits requiring sufficient, appropriate evidence in order for the examiner to give an opinion on the corporation as a whole, based on the criteria. Not only is there a need to ensure that systems and practices are well designed, but also that they are functioning as intended to produce the desired results.

222. For auditing to be cost–effective, it is essential to avoid duplication during the conducting phase of the special examination. Expected corporate results, risks and key systems and practices are interrelated with multiple interdependent links and overlapping influences – in short, the system is complex. Yet, for practical reasons, the special examination fieldwork may be divided up by selected key systems and practices and conducted by different members of the audit team. To avoid errors and duplication of effort, the examination principal's judgment and participation in top–down task co–ordination and allocation are essential.

223. The conducting phase must relate to the planning phase. Thus, if the planning phase was results–oriented and focussed on significant areas, then the examination phase will be results–oriented and focussed on significant areas.

224. The use of ISES is recommended, as it is consistent with the special examination methodology, and maintains the key links between the planning, conducting and reporting phases. It is especially strong in keeping the evidentiary audit trail intact, assists in maintaining a results focus, and in general facilitates efficient and effective examinations.

Evaluating Internal Audit Projects

225. In the planning stage, the examiner carries out a preliminary review of internal audit projects and identifies those relevant to the special examination. At the conducting

stage, the examiner reviews the identified audit projects in greater depth and evaluates and corroborates the specific internal audit work that he or she intends to use, to confirm its sufficiency and appropriateness. The nature and extent of the examiner's corroboration of the specific internal audit work depends on such matters as the risk and significance of the matters subject to audit, the assessment of the internal audit function, and the evaluation of the specific internal audit work.

Sufficient and Appropriate Audit Evidence

226. The special examination is conducted to an audit level of assurance. Consequently, audit evidence should be sufficient and appropriate to achieve that level.

> In an audit engagement (such as a special examination), the practitioner provides a **high, though not absolute, level of assurance** by designing procedures so that in the practitioner's professional judgment, the risk of an inappropriate conclusion is reduced to a low level through procedures such as inspection, observation, enquiry, confirmation, computation, analysis and discussion. Use of the term "high level of assurance" refers to the highest reasonable level of assurance a practitioner can provide concerning a subject matter. Absolute assurance is not attainable as a result of factors such as the use of judgment, the use of testing, the inherent limitations of control and the fact that much of the evidence available to the practitioner is persuasive rather than conclusive in nature. Assurance will also be influenced by the degree of precision associated with the subject matter itself. On the other hand, in a review engagement, the practitioner provides a **moderate level of assurance** by designing procedures so that, in the practitioner's professional judgment, the risk of an inappropriate conclusion is reduced to a moderate level through procedures which are normally limited to enquiry, analysis and discussion. Such risk is reduced to a moderate level when the evidence obtained enables the practitioner to conclude the subject matter is plausible in the circumstances. **Reference:** Canadian Institute of Chartered Accountants – Standards for Assurance Engagements.

227. In the special examination, as in any VFM audit, the auditor's professional judgment must predominate in any assessment of the sufficiency and appropriateness of audit evidence. Sufficiency is a measure of the quantity of audit evidence obtained, and appropriateness relates to its quality in terms of reliability and relevance.

228. Even if the corporation is achieving the results expected, there is a requirement to collect sufficient, necessary audit evidence to confirm the findings. If the likelihood of the related risk event occurring was assessed as low during the survey phase, the information supporting that assessment (for example, meaningful and reliable performance indicators confirming that a particular result is being achieved) forms part of the audit evidence. In most cases, this should result in a reduction of the level of effort needed during the conducting phase, including the need for additional audit evidence. For example, performing in–depth examination work in a few areas within a specific key area may be sufficient.

Factors to Consider in Evaluating Sufficiency and Appropriateness

229. **Relevance.** Relevance refers to the relationship of evidence to its use. The information used to prove or disprove an issue is relevant if it has a logical, sensible relationship to that issue. Information that does not, is irrelevant and, therefore, should not be included as evidence.

230. **Risk.** In determining the sufficiency and appropriateness of evidence, the examiner is guided by the need to minimize the risk of reporting erroneous findings and inappropriate conclusions.

231. Representativeness. The evidence obtained to prove or disprove an issue should not be an aberration or so isolated an incident or transaction as to be meaningless in relation to the matter under consideration.

232. Consistency. Evidence used to prove or disprove an issue should be consistently leaning in one direction or the other.

233. Cost. The cost of gathering the evidence should not outweigh the benefits to be derived in relation to the audit objectives expressed as criteria or sub–criteria.

234. Authoritativeness. Information obtained from an expert, knowledgeable, independent and external source is usually considered more reliable than that obtained within the audit organization.

235. Reliability. The reliability of evidence varies according to its source and type. Generally, evidence obtained directly by the auditor is more reliable that information obtained indirectly, and documentary evidence, including photographs and videos, is more reliable than oral evidence. In the same vein:

- original documents are more reliable than copies;
- evidence obtained from direct physical examination, observation, computation and analysis is better than information obtained indirectly;
- the better the system of internal control, the more likely it is that information produced by the entity is reliable; and
- statements made by officials of the audited organization are more reliable when confirmed in writing.

236. Persuasiveness. The degree of persuasiveness of the evidence is influenced by the reliability of its source. Assurance increases if evidence is corroborated by another source.

237. Timeliness. Evidence should exist in and be relevant to the time period being reported upon in the special examination.

Maintaining the Results–Based Focus

238. Straying from the results–based focus is a common pitfall. Examiners need to be continuously mindful of significance, and must challenge the relevance of the audit task at hand in order to evaluate whether the achievement of a desired result or the mitigation of risk is impaired.

239. There should be a direct link between an expected corporate result or risk area, the related facts and the audit findings. Maintaining this evidentiary chain is how the results–based focus, established in the special examination plan, is sustained through the conducting phase and ultimately into the reporting phase. It also makes for more effective and, efficient auditing.

240. Achieving results is not enough. Achievement of a desired result is not evidence of the existence of appropriate systems and practices. A desired result could arise simply because of favourable external economic factors. Reasonable results may be achieved despite inadequate systems and practices (for example, in a financial institution, adequate loan performance today could be the result of sound lending practices in prior years although current practices are not adequate). It is also possible that desired results are not being achieved despite apparently adequate systems and practices. **Exhibit 16** illustrates the four possible scenarios.

Exhibit 16

Results / Systems and Practices Relationship

		RESULTS	
		NOT ACHIEVED	ACHIEVED
SYSTEMS AND PRACTICES (S&P)	ADEQUATE	Need to consider: 1. Are indicators misleading? 2. Are there external factors that are unfavourably impacting on results? 3. Were S&P recently updated / implemented so that favourable impact on results has not yet occurred?	No Significant Deficiency
	INADEQUATE	Significant Deficiency	Need to consider: 1. Are indicators misleading? 2. Are there external factors that are favourably impacting on results? 3. Are results likely a product of prior S&P (i.e., a timing issue)?

Gathering Evidence

241. Evidence requirements depend upon the areas selected for in–depth examination, as well as upon the criteria. Thus, scoping, which includes risk analysis, is important. If carried out with expected corporate results in mind, the areas selected will be minimized and will require relatively few results–focussed criteria that are nevertheless at a high level.

242. Examination criteria are worded so as to identify which expected corporate result or risk is being addressed by a particular system, practice or process. Examiners would have considered indicators of the achievement of the anticipated results and can at this point use these indicators to provide guidance on the extent of evidence needed to ensure that criteria are met.

243. Following are a number of possible scenarios relating to the achievement of results as measured by criteria:

- Results are being achieved, and systems and practices are sound.
- Results are being achieved, but systems and practices are not sound.
- Results are not being achieved and systems and practices are not sound.

- Results are not being achieved, but systems and practices are sound.

244. Even if the corporation is achieving the results expected, there is still a requirement to collect evidence to confirm the findings. If the results are not being achieved, there is an even greater need to collect evidence to determine the cause of failure. Appropriate professional judgment is always key. It is important to remember that the evidence gathered must be able to withstand challenges by the corporation's management.

245. **Technique.** Key systems and practices are selected on the basis of expected corporate results and risk analysis. Criteria are expressed in terms of how best to assess the achievement of these results or the mitigation of risks. A good starting point in the evidence–gathering stage, therefore, is to ask corporate managers how they obtain reasonable assurance that they are in fact on track.

246. The special examination plan should already have a section on performance, which comprises a wide range of indicators (not just financial ones). The examiner should ask managers (at different levels) how they know if they are doing well or not. Are lower–level performance indicators or other indicators linked to the corporation's high–level indicators, if any? If not, the corporation may have activities that are not linked to its mandate, or the high–level indicators, often used to report to Parliament, are not being used to manage.

247. A wide range of techniques and procedures, such as other interviews and inquiries, inspection of physical plant and operations, review and analysis of documents and reports, confirmation, replication and testing can then be used to confirm the views expressed by management.

248. **Corroboration.** While ultimately fact driven, many aspects of the special examination are more subjective, leave greater room for alternative interpretations and are generally more dependent on professional judgement than most attest or VFM audits. There is a particular need, therefore, to take great care to independently corroborate facts and findings.

249. **Access.** The examiner has the right to receive such information concerning the Crown corporation or any subsidiary corporation as is necessary to prepare a report under the provisions of the FAA, and as the present or former directors, officers, employees or agents of the corporation can reasonably furnish.

250. **Reasonableness.** It is expected that evidence would be able to pass the "reasonable person" test, and the degree of persuasiveness should be high, particularly in sensitive or controversial areas.

Detailed Audit Procedures

251. The evidence–gathering process includes, among other things, designing and carrying out audit procedures or tests (audit programs).

252. The audit principal, through the special examination plan and direct supervision of fieldwork, directs and guides the work performed during the conducting phase. Detailed audit procedures are an element of this direction and guidance.

253. Audit programs or procedures combine a number of important functions. They provide a road map to the work to be done, and to the resulting working papers. Also, audit programs tailored to a particular set of circumstances become a key to maintaining the link between the results–oriented special examination plan and the execution of that plan in the conducting phase.

254. Detailed audit procedures may be developed at different levels, in order to test criteria; sub–criteria or a logical grouping of these. This is a matter of professional judgment.

255. The development of an audit program involves:

- incorporating criteria or, more likely, sub–criteria for verification;
- specifying the evidence to be collected; and
- outlining, at an appropriate level of detail, the specific procedure for collecting and analyzing the evidence.

256. What constitutes an appropriate level of detail is a matter for the principal's professional judgment, and will be influenced by several factors, including but not limited to:

- the complexity of the audit task;
- the relative importance of the expected corporate result or risk being tested by the audit criteria or sub–criteria;
- the skill and experience of the examiner to whom the work is to be assigned; and
- the extent of reliance to be placed on the results of the audit task by other staff or consultants participating in the special examination.

Findings Summary and Analysis

257. The evidence–gathering process results in the accumulation of facts, which are confirmed through the application of audit techniques.

258. **Facts v. findings.** A fact is something that can be proven to be true. A finding, on the other hand, is derived from one or more facts by applying professional judgment. Findings may also be arrived at by combining facts with other findings, or by combining two or more findings into another finding. Findings may be regarded as preliminary conclusions.

259. **Iteration.** During the planning phase of the special examination, auditors begin to accumulate facts and formulate findings that are progressively either confirmed or negated, in whole or in part, during the conducting phase. Thus, the conversion of facts into findings is an iterative process, that is, one that continues throughout the whole special examination, including even the reporting phase.

260. **Analysis.** Facts and findings may impact more than one expected corporate result, risk, criterion or sub–criterion. To accommodate documenting, it is strongly recommended that ISES be used to store and analyze facts (referred to as "key messages" in ISES) and findings. Regardless, the assessment process employed for analysis encourages maintaining the tight connection between the results–focussed special examination plan, the general criteria, the sub–criteria, the facts, the related evidence and the findings.

Quantifications of Facts and Findings

261. Traditionally, special examination plans have contained significant quantitative information describing the client's operations and business environment. However, with respect to audit observations, extensive quantification has not been a characteristic of

VFM audits, and this has been equally true of significant deficiencies in the special examination report. There is both a reasonable demand and an opportunity for quantification of observations. Where quantification of facts and findings adds value to the special examination report, examiners are strongly encouraged to do so.

262. The focus on results – which was initiated by the Office and is preferred by clients – virtually demands that the "So what?" question be answered. Where the weight of the Office has been placed behind a finding identified and characterized as a "significant deficiency", the reader has a right to expect the rationale for the conclusion and a quantification of the impact. Quantification frequently adds clarity and understanding, and without it there is an increased likelihood that an issue will be received indifferently by the management of the corporation.

263. The FRLs are key resources in the promotion of more and better quantification of significant deficiencies. The FRL Crown corporations may be consulted for advice in this area. As early identification of quantification options is important, auditors are encouraged to seek FRL advice in a timely fashion.

264. Approaches to quantification. Performance indicators and benchmarking have been used successfully in special examinations and are highly encouraged. The corporation's actual performance provides an indication of the extent to which it is managing inherent risk and achieving its intended results. In the planning phase, a review of performance indicators and benchmarking data helps the examiner to gain an understanding of the business, can help in deciding how much work is likely required in an area, and can assist in supporting findings. During the conducting phase, such data may be used as key comparative tools for the interpretation and analysis of facts and findings.

265. Performance indicators. During the planning phase, the examiner will have established whether the corporation has a complete set of performance indicators, likely by posing questions such as the following:

- Are there indicators for all critical success factors within the corporation?
- Should the corporation, and does it, have indicators related to its public policy objectives, internal processes, financial viability, clients and employees and to the environment?
- Can the corporation be reasonably expected to have quantitative performance indicators for all of its objectives and activities?
- Are indicators lacking due to an unclear mandate, objectives or strategies?
- What indicators are similar entities using?

266. A cluster, or family of meaningful (understandable, relevant and comparable) quantitative performance indicators may be used to demonstrate the implications of a finding. A review of existing indicators may also help to identify expected corporate results that the examiner has not identified, or expected corporate results where the corporation has no indicators; in such cases, one can ask how the corporation is able to manage the area and the associated risks, and how it can adequately report to Parliament.

267. Benchmarking. True benchmarking is not a comparison of similar activities between organizations, but rather an ongoing comparison of the activities within one organization to the "best practices" within similar organizations, so true benchmarking is not always practical for special examinations. Nevertheless, it may be worthwhile to perform a simple comparison of like activities.

268. In deciding what to benchmark, it is very important to consider the time involved and the resources (funds and people) required. A cost–benefit analysis is

appropriate to determine if the value of the information obtained would offset the time and costs involved. Other considerations include:

- Does the corporation have any benchmarking information? (Many Crown corporations are already benchmarking as part of their business approach.)
- Is this particular benchmarking information already available elsewhere? (It is possible to purchase certain types of benchmarking information – particularly from organizations in the US.)
- Can the benchmarking information be obtained through competitive/business intelligence (that is, by retaining consultants who specialize in competitive or business intelligence information)?

269. Alternatives to Conducting a Benchmarking Exercise. The examiner should use the Crown corporation's benchmarking information when possible (many Crown corporations are already benchmarking as part of their approach to business). Purchase benchmarking information when possible (certain types of benchmarking information are available for purchase, particularly from US organizations). Consider competitive or business intelligence as a means of obtaining benchmarking information. Retaining consultants who specialize in competitive or business intelligence is also an option, particularly when it is not possible to exchange information with benchmarking partners.

Clearing Facts, Findings and Conclusions with Management

270. Facts, findings and conclusions will already have been articulated and summarized on Findings Summary and Analysis sheets (useful for clearance with management), either manually or within ISES. Client comments, including any changes planned or already underway, should be recorded.

271. Throughout the examination, the examiner should maintain ongoing communications with the managers responsible for the areas being examined. As the conducting phase draws to a close, the facts, findings and conclusions for each area are cleared with the appropriate managers.

272. At this stage, the examiner cannot finalize the contents of the examination report because this will require looking at the corporation as a whole. However conclusions can be made on whether or not each sub–criterion has been satisfied and, if not, on whether the matter in question is potentially significant.

Examination Files

273. The documentation in the special examination files provides the essential substantiation for the opinion to be reported. Because of the need to give positive assurance, adequate documentation of the judgment exercised by the examiner is essential.

274. The files should clearly show the sources for the expected corporate results and risks; the analysis giving rise to the identified key areas, selection of criteria and sub–criteria; and with the rationale for selection of systems and practices examined in–depth. The basis for internal audit, and the extent of reliance on it, should be clearly shown.

275. Evaluation decisions. The team needs to adequately document the evaluation of examination findings and reporting decisions, as these are judgment areas where reasons

for decisions are often the result of discussions between team members, with FRLs or advisory committee members.

276. Corroboration. Findings can be elusive in the special examination because of the high degree of professional judgment required in many instances. Examiners need to have corroborative sources clearly referenced and accessible in the files, so that rapid follow–up and future reference is facilitated and the sufficiency of evidentiary material is clear for all to see.

277. The examiner should ensure that files are complete, systematically organized, indexed and cross–referenced. At a minimum, special examination files should contain:

- appropriate documentation of matters examined, including the corporation's policies, systems, controls and procedures and the rationale for the systems and practices selected for in–depth review;
- the reasons for performing specific procedures and tasks and the relationship to the statutory control objectives;
- the examination audit programs, procedures or tests and the nature and extent of the work done in carrying these out;
- details of discussions with management, including the dates, names and titles of persons present;
- the response of management, including details and dates of any corrective action;
- evidence that supervisory review of work was completed at appropriate management control checkpoints; and
- advisory committee comments and advice from external experts along with an indication as to the disposition of such advice.

278. The special examination file must be capable of standing alone to support, to an audit level of assurance, all the matters contained in the special examination report.

Draft Special Examination Report (refer to Appendix 3)

279. A draft report should be developed as soon as possible in the examination process and periodically revised during the examination. A draft report provides a basis for managing evidence in carrying out preliminary analysis, and assists in maintaining both the results focus and the ultimate objective (that is, the examiner's special examination report).

280. The draft examination report becomes an evolving document, shifting and changing with the iterative process that so uniquely characterizes the special examination. Great care needs to be taken in relation to the draft special examination report that examiners at all levels maintain an open mind: the draft report should remain just that, and not become a self–fulfilling prophesy.

281. As information is collected, it is arranged against the preliminary audit results, which are modified in light of ongoing preliminary analyses. The examiner periodically assesses the extent of the evidence supporting each fact and determines whether further examination work is necessary. This method of managing evidence allows for continuous fine–tuning of the audit approach and reduces the risk of over–auditing.

282. Once the examination principal has determined that sufficient and appropriate evidence has being collected, there is a need to conclude whether or not the criteria have

been satisfied. Are the desired results being achieved by way of the systems and practices utilized? Are the risks to continued achievement of results being adequately managed? If desired results are not being achieved, the examiner needs to identify the causes. However, absence of any current problems does not necessarily mean that there are no significant deficiencies. There could be risks to the corporation that have not yet materialized and for which the corporation has not put in place adequate controls. In drawing conclusions, reference to industry practices or benchmarks may help to determine the validity or usefulness of the corporation's control systems and practices.

283. Any corrective actions taken by the corporation to address previous special examination deficiencies, as well as initiatives to address current deficiencies, should be discussed in the report.

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Reporting the Special Examination

Policies for Reporting the Special Examination

General Policies
• Office practitioners should comply with CICA standards for assurance engagements, special examination policies, CAM common policies, and OAG special examination methodology. Any deviation should be approved by the examination Principal and the responsible Assistant Auditor General (AAG). • Where the Office is involved in a joint special examination, the examination team should ensure that the work performed by the joint examiner is sufficient and appropriate to support the joint report. • As part of ongoing knowledge of the corporation, the entity team should be aware of the corporation's actions in response to significant deficiencies reported in past examinations.
Policies Related to Consultation

• The advisory committee (internal and external specialists and senior Office staff), the appropriate functional responsibility leaders (FRLs) and the second reviewer should be consulted when the issues are unusual, complex, controversial, or require specialized knowledge or experience. At a minimum, the examination team should obtain input at the following critical times:
  • Planning phase: when discussing expected corporate results, risks, key areas and examination criteria, and when drafting the examination plan;
  • Conducting and reporting phases: when discussing significance of deficiencies and reporting strategies, and when drafting the long–form special examination report.
• The examination team should keep the corporation informed about the existence and resolution of any sensitive examination issues.

Policies Related to the Reporting Phase
• When one or more criteria are not sufficiently met, placing at risk the achievement of one or more statutory control objectives, the examination team should report a significant deficiency. • Examination findings should be reported beyond the board of directors of the Crown corporation when, in the Auditor General's opinion, they should be brought to the attention of the Minister or Parliament. • A Special Examination Report Clearance Memorandum in the approved format should be prepared and signed by the examination Principal, responsible AAG, DAG and the Auditor General to document the completion and clearance of the examination. • The examination team should issue a long–form special examination report on a timely basis. Any significant deficiency should highlight the problem, its cause and its effect. • The examination team should, on a timely basis and as appropriate, provide the corporation with other relevant information it has gathered during the examination.

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9 Reporting the Special Examination

Introduction

284. The FAA requires the examiner, on completion of the special examination, to submit a report to the Board of Directors that includes:

- a statement of opinion as to whether, with respect to the criteria established in the examination plan, there is reasonable assurance that there are no significant deficiencies in the systems and practices examined; and
- a statement of the extent to which the examiner relied on internal audits.

285. For Crown corporations named in Part 1 of Schedule III of the FAA, matters may be reported to the minister and Parliament if, in the examiner's opinion, there is information that should be so reported. However, nothing in Part X of the FAA or in the regulations authorizes the examiner to express any opinion on the merits of matters of policy, including the merits of the corporation's objectives.

286. This section deals with the work required to meet the legislative requirement to report on the results of the special examination. The key activities in reporting are summarized below:

- Determine the significant deficiencies to be reported.
- Prepare a draft special examination report.
- Discuss the draft report with the advisory committee, the corporation's management and the audit committee.
- Finalize the report; submit it to the board of directors, and to the minister and Parliament, (if necessary).
- Bring to management's attention any deficiencies that are not deemed significant to the board but that still merit attention.

287. Deficiencies reported should represent the results of the examination, should be consistent with the findings and conclusions, and should be clearly reported to the board. Causes and consequences of the problems form part of the description of the deficiencies and assist in their being understood.

Reportable Matters

288. The Office takes the position that while it is required to report significant deficiencies, this does not preclude also reporting matters that in the judgment of the examiner, ought to be brought to the board's attention.

289. On the other hand, for a matter to be reportable – whether considered significant or not – it ought to be of sufficient consequence as to be of interest to the board of

directors. In short, forming a judgment of what is reportable, yet not a significant deficiency, is just as important to as deciding upon what, in the circumstances, constitutes a significant deficiency.

290. If a finding is not deemed of interest to the board of directors, it should not normally be included in the special examination report. However, the examiner may choose to communicate these less important matters to management verbally or by way of a management letter or other document.

Assessing the Significance of Deficiencies

291. Determining the significance of a deficiency. The FAA does not define what is meant by a "significant deficiency". The Office states that a deficiency is significant when it renders it likely that a statutory control object will not be achieved.

292. Significance is judged in relation to the reasonable prospect of a matter influencing the judgments or decisions of a user of an audit report. For example, factors that may influence the auditor's judgment as to what is significant in a particular circumstance might include the potential public, legislative, economic or environmental impact.

293. A significant deficiency occurs when there is a deviation from criteria AND that deviation prevents reasonable assurance that the statutory control objectives (that is, assets safeguarded, resources managed economically and efficiently, and operations working effectively) are achieved by way of the systems and practices of the corporation.

294. Clearly, significance is a matter of judgment and depends on the circumstances. Ultimately, one of the major deciding factors is the identified or potential impact of a deficiency.

295. The examiner may take the following factors into account when determining whether a finding constitutes a significant deficiency:

- **Extent of deviation from criteria.** A finding should be clearly linked to criteria and, for it to be significant, there should be substantial deviation from criteria. Where there are deviations, the examiner needs to establish whether there are compensating systems or practices to assist in achieving the desired result.
- **Impact of the deficiency.** The expected corporate result, to which criteria are linked, should be materially at risk of not being achieved. To be significant, the impact of the deficiency on the achievement of the corporation's objectives and expected corporate results and on the statutory control objectives should be clear, serious and consequential. When selecting key systems and practices and developing criteria, considering the corporation's exposure to risk will help in tracing the impact of any deficiencies subsequently identified. The impact may be potential: the consequences may not have materialized yet.
- **Relevance to the board, the minister or Parliament.** The examiner should consider what is of interest and relevance to the board. If a finding is of little or no consequence to the board, it may not be significant. Relevance to the users of the report is related to impact (so what?) as well as to the cause (why did it happen?). Of course, there may be a difference of opinion between what the examiner believes is relevant to the board and the corporation's views on the issue – in which case the examiner would report the deficiency as significant if convinced of its consequence to the board.
- **Practicality of the solution.** If the likely cost of correcting the deficiency is greater than the benefit to be derived, the significance of the deficiency may be questionable.

- **Number of reported deficiencies.** Minor deviations from several criteria may signal minor problems, or may be symptoms of a problem (or theme) of greater significance that should be reported as a significant deficiency.
- **Planned corrective actions.** If the corporation has action plans in place or even in process to correct deficiencies that have been classified as significant, these deficiencies should still be included in the report as significant because they existed during the examination period and because there is no assurance that the planned actions will correct the problem or that the actions will continue after the report date.

296. Formulating significant deficiencies. Significant deficiencies must have a clear evidentiary link to the criteria. Problems can be encountered in the reporting phase, largely relating to the clarity of criteria and their relationship to the significant deficiencies. Such problems often occur when the wording used to describe the deficiencies is too general and when a results orientation has not been adequately carried through in the audit. For example, the significant deficiencies may not show the impact on intended results. If the planning and conducting phases have focussed on potential significant deficiencies, the reporting phase will be much easier than if the examination has amassed a lot of findings without determining how they relate to the corporation's overall objectives and expected corporate results, and to the statutory control objectives.

297. In order to be clear and meaningful, significant deficiencies should identify the problem, its cause (which is often general or multi–dimensional) and its effect.

Exhibit 17

CAUSE	PROBLEM	IMPACT
Poor planning	Poor allocation of resources	Low productivity
Poor allocation of resources	Low productivity	Failure to be competitive
Low productivity	Failure to be competitive	Loss of market share

298. For example, in **Exhibit 17** there are three significant deficiencies identified (one in each row), all three trying to describe the same deficiency. From a review of significant deficiencies, it may not always be clear what the problem is nor may it be clear what the impact or cause is in all cases. If the "cause" is not known, perhaps the "problem" is really a "cause", and a different problem exists. The impact should be the expected result that has not been achieved because of a problem. Further, the cause should be something which, if fixed, would likely solve the problem. In the examples shown in **Exhibit 17**, each of the deficiencies would likely require a different solution, thus the need to ensure clarity in identifying and reporting significant deficiencies.

299. The three components of a significant deficiency (problem, cause and impact) require judgment in their determination, as they may not be obvious. For example, causes are often multidimensional.

300. Recommendations are not necessary. Since addressing the cause or causes should correct the problem, recommendations are not required. Similarly, findings

reported in letters to management do not need recommendations attached. The reasons behind this position are:

- there is no requirement under the FAA for any management letter;
- action in response to findings is management's prerogative; and,
- the cost to the Office of formulating recommendations may be excessive.

Reporting Beyond the Board of Directors

301. In the case of special examinations of Part I, Schedule III Crown corporations, the examiner must decide whether the special examination report contains information that should be brought to the attention of the appropriate minister or Parliament. If the examiner believes that certain information should be reported beyond the board, the board of directors of the corporation must be consulted and furnished with copies of the information given to the minister. Where the examiner believes that certain information should be brought to the attention Parliament, then the board of directors, the appropriate minister and – in the case of a private–sector examiner – the AG must be consulted and furnished with copies of the items reported.

302. Four main types of significant deficiencies warrant reporting beyond the board:

- mandate issues;
- issues that only the government can address;
- issues of a governance nature; and
- repeat significant deficiencies.

303. **Mandate issues.** Two types of mandate issues may arise. The first type is the situation where the corporation is failing to comply with its legislative mandate in a material way. The second type would arise when management cannot, in the prevailing circumstances, comply with some part of the mandate given to the corporation by Parliament. In the latter situation, the examiner must take great care to ensure that matters relating to government policy, and therefore falling outside the scope of the special examination under the FAA, is not being commented upon.

304. **Issues that only the government can address.** To the extent that any events outside the control of the corporation may reduce the corporation's ability to be reasonably assured that the statutory control objectives are achieved, significant deficiencies would be reported. However the reporting strategy may require the report to be provided beyond the board to the appropriate minister or to Parliament, so that the deficiency may be more readily addressed.

305. **Issues relating to corporate governance.** Governance is important, and many significant deficiencies are related to it directly or indirectly. However, only a general knowledge of corporate governance, likely obtained at the planning phase, may be required in a results–oriented special examination. It is thus unlikely that governance itself would be identified as a significant deficiency.

306. Furthermore, the cause–effect link between good corporate governance and good performance may not be clear, and would therefore be inconclusive. If, however, during the planning phase, the examiner was able to obtain indications that there were governance problems, then the risks to the corporation as a whole would likely increase, and there might be a need to examine more areas in greater depth to ensure that the expected corporate results are achieved. If results are not achieved in a certain area, a

significant deficiency would likely be reported, but with reference to governance matters as a possible cause of.

307. However, since governance is essentially a board issue anyway, and the special examination report is generally provided to the board, the rigour to determine who is responsible for the deficiency may not be required. Also, in such cases it is difficult and probably speculative to attribute cause to any one party along the accountability chain. In short, citing corporate governance as a significant deficiency, while possible, is rare; but if it warrants being so–cited, it probably requires reporting beyond the board.

308. **Repeat significant deficiencies.** Where a corporation has failed to deal with a significant deficiency identified in a previous special examination, it may be appropriate to report beyond the board.

309. The decision to report beyond the board should be taken before drafting the special examination report, so that it can be discussed with the advisory committee, the corporation's management and the audit committee as part of the report clearance procedure. Determining what should be reported beyond the board requires professional judgment. In general, reporting to Parliament through the corporation's next annual report would take place on an exception basis.

310. In making such decisions, the examiner would focus on the role and accountability of the appropriate minister of Parliament. For example, when determining whether any information should be reported to the minister, the examiner would consider whether the deficiencies in the systems and practices result in:

- the board of directors not being able to adequately perform its functions on behalf of the shareholder, or failing to render appropriate accountability to the shareholder;
- the minister not having access to the information needed to serve as an effective "trustee" shareholder on behalf of the government and, ultimately, of Parliament and taxpayers; or
- the government being unable to discharge its responsibility for the major strategic and budget decisions of Crown corporations.

311. Where matters are to be brought to the attention of the minister, the practice to date has been to provide the full special examination report to ensure context and relevance.

312. **Inclusion in the corporation's Annual Report.** Where there are matters to be reported to Parliament, a separate report should be prepared for inclusion in the next annual report of the corporation, indicating that it is based on the results of the special examination. A report prepared for Parliament would provide a clear, succinct description of the matter(s) being reported. It would convey the nature and consequences of the significant deficiencies, reported in such a way that it is clear why Parliament is being informed. Significant deficiencies that have been deemed appropriate for inclusion in the annual report of the corporation may, upon being made public, be considered for subsequent inclusion in the AG's report as audit notes.

313. The transmittal letter is the means of formally communicating to the board that the special examination report is being brought to the attention of the minister or that particular issues are to be included in the next report of the corporation. As the date for finalizing the corporation's annual report draws closer, the Office should provide the corporation with the precise wording to be included.

Preparing the Report (refer to Appendix 3)

314. A special examination report must be able to stand on its own and not be subject to different interpretations than those intended by the examiner.

315. The purpose of the special examination is to report to the board of directors whether, considering the corporation is a whole, systems and practices provide reasonable assurance of the achievement of the statutory control objectives. In forming this opinion, the examiner needs to evaluate the deficiencies identified to determine their significance at the level of the board of directors.

316. **Reporting reliance on internal audit.** The examiner should refer to areas of the report that relied on internal audit, making reference only to the reliance and not to the degree of reliance. Where reliance was not possible, the report need only state that either there were no internal audits or the internal audits did not address matters covered by the special **examination.**

317. **Qualifications.** Where the opinion is qualified because of one or more significant deficiencies, descriptions should be relatively succinct but should convey the nature, importance and actual or potential effects of each significant deficiency on the achievement of the statutory control objectives or expected corporate results. The description of each significant deficiency should be structured around the following elements:

- the nature of the problem;
- the likely causes; and
- the impact on expected corporate results and statutory control objectives.

318. **Period under examination.** The period of the examination is from the date the examination started (usually the beginning of fieldwork) to the date of substantial completion of the conducting phase.

319. **Dating of the report.** The report should be addressed to the corporation's board of directors. The date shown on the report (below the AG's signature) should be the completion date of the fieldwork required to express an opinion (usually once facts and findings have been cleared), even though the report may not be prepared or issued until later. There is obviously some flexibility in establishing the dates for the period under examination and for the report, but large gaps between these two dates and the date the report is transmitted to the board should be avoided (also refer to the discussion of "Subsequent Events" later in this section). The date on the transmittal letter accompanying the special examination report is the official completion date. The subsequent special examination is to be completed within five years of this date.

320. **Short–form report versus long–form report.** The short–form report is no longer used for reporting special examinations. Whether there are significant deficiencies or not, the long–form reporting format should be used. This type of report is preferred and has been adopted because it is more consistent with adding value to the corporation and because it includes all matters that, in the judgment of the examiner, ought to be brought to the attention of the board of directors.

321. In order to improve the usefulness of the report to the board of directors, it should include the examination mandate and objectives, and a description of the scope, including the period under examination. The report should identify the criteria used as the basis for forming the opinion, by way of an appendix. The plan should be identified and referred to in the examination report. It also should include all the key findings, whether negative or positive. The aim is to combine balanced and fair reporting while adding value for the client.

322. Where an appendix is used to elaborate on significant deficiencies, on the relationship to the examination criteria or on other matters being brought to the attention of the board of directors, it should not describe any deficiencies other than those identified in the main body of the report. Any other matters can be included in a separate management letter.

Clearing and Finalizing the Report

323. A draft of the special examination report (or a summary of the conclusions reached) is normally provided to corporate management for review. The purpose is to give management the opportunity to initiate corrective action as early as possible or to start work on any report it may wish to submit to the board of directors in response to the special examination report. The examiner may also wish to review the draft report with members of the board's audit committee as a means of gaining further input and clarifying of matters raised therein.

324. **Clearance before meeting advisors.** In most circumstances, the draft report should be cleared with client management before the examiner seeks the counsel of the advisory committee.

325. **Advisory Committee.** Once a draft of the special examination report has been prepared, the advisory committee should review it. In the reporting phase of the special examination, the examiner would seek the advisor's input as to:

- the adequacy of the evidence to support all the reported findings;
- the conclusions drawn as to the significance of the deficiencies found; and
- the appropriateness of the reporting strategy proposed.

326. At this stage, the examination team prepares a report clearance memorandum summarizing the key points in the special examination, and recommending that the AG sign the special examination report.

Submitting the Final Report

327. When the special examination report has been signed, it may be sent to the audit committee for discussion before being formally submitted to the board of directors. The purpose of this review is to allow members of the audit committee to pose questions that will help them understand the report and provide appropriate advice to the board of directors. The audit committee may request that management responses be provided along with the report, and these could be included in an appendix. It is not necessary to obtain the audit committee's concurrence on the report: it is the examiner's report to the board of directors.

Subsequent Events

328. It is preferable to issue the special examination report as close to the end of the field work as possible, although this may not always be easy to do. If the report is issued many months after the fieldwork is done, numerous changes may occur. The board is concerned with issues of continuing relevance, so if a report is delayed, a subsequent events review would be in order to ensure the report's currency.

329. The period of time that needs to have elapsed before a subsequent event review is required is a matter of judgement, depending on the particular circumstances.

330. In general there are two types of subsequent events:

- those that provide further evidence of conditions that existed at the reporting date; and
- those that are indicative of conditions that arose after the reporting date.

331. The extent and the manner in which the effect of a subsequent event is reflected in the report will depend on the examiner's professional judgment.

Management Letters and Transfer of Information

332. It is likely that, in the course of the special examination, the examiner has made other observations that could be useful to management. Normally, the examiner would communicate with management throughout the special examination so as to validate facts and to explain any conclusions reached.

333. The examiner should provide management with conclusions and information in relation to the criteria that would, in effect, constitute the management letter in addition to the report. Providing information relevant to management is a means of ensuring that maximum value added is derived from the special examination process.

334. Such information could include findings relating to failures to meet some criteria, but nevertheless judged to be either of low significance in terms of the expected corporate results or statutory control objectives, or matters of little interest to the board of directors.

335. **Recommendations.** It is not necessary or even desirable that examination staff develop recommendations for any facts and findings that they wish to bring to the corporation's attention.

336. Project reports prepared in the course of the special examination may be provided to the corporation's management where doing so is consistent with adding value.

337. **Work of consultants.** In the course of the special examination, it is not unusual for the examiner to commission consultants to prepare reports on specific areas, issues or problems. Consultants should be made aware that the results of their work might be provided to the corporation where doing so would add value to the special examination.

Appendix 1: Quality Management System and Practices

Background and Framework

The Auditor General notes in the Foreword of the Office's Code of Professional Conduct: "The Office has maintained a level of excellence and established a credibility among Parliamentarians, taxpayers and the media that has no equal." It is important to maintain the level of quality in special examinations that contributed to this reputation.

The commitment to quality is reinforced in the Office's Strategic Framework. One of the key strategies is to implement a co–ordinated and efficient Quality Management System (QMS) for all OAG products.

While there are various models of quality control and quality management, they are based largely on a number of common design principles. The key principles are:

- Quality should be built into the production process rather than relying on post–production audits or checklists.
- Each player in the control process should have clearly defined responsibilities, and these should be properly communicated.
- Controls should respond to key risks in a timely manner.
- The control process should be as efficient as possible.
- Controls should be built with an appropriate mix of external, corporate, group, team and individual checks.
- Controls should be results–focussed.
- Practitioners should participate in the continuous evolution of the control framework.

The following **Table** shows the key instruments employed to ensure that special examinations satisfy the eleven quality management elements of the QMS.

Quality Management Element	**This element of the Office's Quality Management System should provide reasonable assurance that:**	**Key Instruments & Practices Employed**
Examination Management		
1. Authority	• The Office undertakes examinations only where it has the authority to do so and, in those limited circumstances in which the Office can exercise discretion in accepting an engagement, where the examination poses no undue risk to the Office.	Financial Administration Act (FAA) and Entity Specific Legislation Orders in Council **SE policies (#2)** and guidance CICA Standards for Assurance Engagements (5025.16 & .20) Legal Services team advice and support

Quality Management Element	This element of the Office's Quality Management System should provide reasonable assurance that:	Key Instruments & Practices Employed
2. Independence, objectivity and integrity	• Personnel are free of any obligation or interest in their audit entities; • Personnel are honest and candid at all times, and have due regard for confidentiality of the audit entities' affairs; and • Personnel maintain an impartial state of mind when carrying out examinations.	FAA (S.135) Office Code of Conduct (4.05, 6.05 & 6.19) OAG General Policies (Conflict of Interest, Fraud or other Illegal Acts) CICA Standards for Assurance Engagements (5025.24); CICA Public Sector Auditing Standards on: VFM Auditing (PS5400.14) and Engaging and Using Specialists in VFM Audits (PS6430.12 to .15) OAG Conflict of interest declarations/re–certification and related guidance OAG Legal Services team advice and support TB Conflict of Interest and Post Employment Code for the Public Service

Quality Management Element	This element of the Office's Quality Management System should provide reasonable assurance that:	Key Instruments & Practices Employed
3. Conduct of the examination	• The Office has in place an appropriate examination methodology, recommended procedures and practice aids that result in efficient examination approaches and in turn produce sufficient, appropriate examination evidence at the appropriate time for the Office to meet its reporting responsibilities. • Communication of significant matters takes place throughout the examination process between examination teams and in management of the audit entities.	**SE policies (all)** and guidance OAG Methodology for SEs Integrated Special Examination System (ISES) CICA Standards for Assurance Engagements (5025); CICA Standards on Using the Work of Internal Audit (5050); and CICA Public Sector Auditing Standards on: VFM Auditing (PS5400), Planning VFM Audits (PS6410), Knowledge of the Audit Entity in Planning VFM Audits (PS6420) & Engaging and Using Specialists in VFM Audits (PS6430) FRL – SE review of all key documents (Plan, Report & RCM) FRL for the SE Practice to provide advice Methodology review and update mechanisms for SE policies, methodology and guidance
4. Consultation	• When dealing with complex, unusual or unfamiliar issues, examination teams refer to authoritative literature and seek the assistance of Office specialists and/or individuals from outside the Office with appropriate competence, judgment, and authority.	**SE policies (#7& 8)** and guidance Advisory Committees FRLs – SE and others Approved templates for SE Plan and Report 2nd reviewers (principal or AAG) Access to external specialists and experts Information technology and Legal Services

Quality Management Element	This element of the Office's Quality Management System should provide reasonable assurance that:	Key Instruments & Practices Employed
5. Security, access, and file retention	• Personnel have security clearance appropriate for the nature of documentation they will be required to access; • There are appropriate restrictions on the access to examination files (electronic and hard copy) and related examination reports; • Examination files are retained for an appropriate length of time.	SE Guidance OAG Code of Conduct (4.10) OAG Security policies and guidance, including Security review and update mechanisms; Security Officer in place Security clearance procedures
People Management		
6. Resourcing	• Examination teams have the qualifications and competencies to enable them to carry out exams. • Personnel assigned to specific engagements have the appropriate technical training and proficiency to carry out the work.	**SE policies (#6, 7 & 9)** and guidance OAG Human Resources policies and guidance CICA Standards for Assurance Engagements (5025.28 & .31) SE Resource Scheduling Exercise as part of R3 Plan Centralized OAG Human Resource function
7. Leadership and supervision	• Managers provide an appropriate level of leadership and direction, and foster an environment in which all team members are encouraged to perform to their potential. • Personnel are properly supervised and coached in their work.	**SE policies (#9, 12& 16)** and guidance CICA Standards for Assurance Engagements (5025.46) Special Examination Management Committee providing leadership and monitoring OAG Human Resources policies and guidance OAG Mentoring Program AAG involvement in SE and DAG/AG involvement through Advisory Committee

Quality Management Element	This element of the Office's Quality Management System should provide reasonable assurance that:	Key Instruments & Practices Employed
8. Performance management	• Personnel receive timely and constructive feedback on their performance. • Personnel have access to counselling, guidance and monitoring to help them manage and develop their careers. • Personnel selected for advancement are competent and fully qualified.	OAG Human Resources policies and guidance Centralized OAG Human Resource function Office Performance Management System, including assignment and annual objectives and appraisals OAG counselling, guidance and monitoring processes OAG promotion processes
9. Professional development	• Personnel undertake professional development through such means as on–the–job training, formal courses, self–directed studies, and internal and external assignments.	OAG Human Resources policies and guidance Centralized OAG Professional Development function Professional development through such means as on–the–job training, formal courses and workshops, self–directed studies, and internal and external assignments Library resources OAG Self–Learning Center OAG counselling, guidance and monitoring processes

Quality Management Element	This element of the Office's Quality Management System should provide reasonable assurance that:	Key Instruments & Practices Employed
10. Respectful workplace	• Personnel demonstrate and encourage behaviour that leads to a respectful workplace that develops highly skilled, motivated and productive people who contribute to fulfilling the mission of the Office. • Personnel respect and value diversity in the Office.	OAG Code of Conduct (6.04) OAG Human Resources policies and guidance, including Discrimination and Harassment Policy and Health and Safety Policy Centralized OAG Human Resource function Official Languages Act and Employment Equity Act Justice Canada mediation program OAG Harassment co–ordinators
Continuous Improvement		
11. Practice review	• The Office carries out internal reviews of its practice to assess the extent to which it meets these quality management criteria for the SE Practice.	OAG practice review policy and program OAG Internal audit CEO and Chair surveys FRL – SE review of lessons learned for each cycle and sharing of results with practitioners FRL – SE monitors external initiatives/developments that might impact on SE practice issues

Discussion of Key Instruments and Practices

Policies specific to special examination product line – A number of policies have been developed specifically for the special examination product line. They clearly define the roles and responsibilities of all parties involved in special examinations. They address the key risks related to conducting special examinations while promoting quality during the process but not compromising efficiency.

Communication of responsibilities – The policies, which clearly define the roles and responsibilities of each player, have been properly communicated to all special examination directors, principals, AAGs, DAGs and the AG through a separate mailing, as well as to all practitioners through this manual. Roles and responsibilities are also often discussed during regular practice issue meetings between the FRL and the practitioners.

Accountability through the examination principal – The principal in charge of a special examination reports directly to the AAG and is responsible for the quality, timeliness and cost of the work undertaken and for applying OAG policies. He/she has to ensure that the examination team has the appropriate disciplines, skills and experience levels necessary for the assignment. The principal consults with internal and external specialists and senior OAG staff, as necessary, when dealing with unusual, complex or controversial issues, or other matters requiring specialized knowledge or experience. He/she also has to ensure that all important decisions are well documented.

Assistant Auditor General involvement – The AAG is responsible for guiding the principal in applying policy, and for assuring the DAG that the work of the Office meets appropriate cost, quality and timeliness specifications, and that departures from policy or methodology are justified.

In planning the examination, the AAG and the principal must promote a focus on significance and maximize the added value to the corporation. Both the principal and the AAG should be involved in most if not all of the following activities:

- consulting with board members and stakeholders;
- getting senior management buy–in and involvement;
- identifying and managing the corporation's expectations;
- ensuring that the team has a clear understanding of how the corporation views its mandate and objectives, and clarifying any differences the Office may have in interpretation;
- reviewing the corporation's governance practices;
- identifying expected corporate results, risks, key areas and criteria; and
- identifying industry experts, advisors and consultants who should participate in the examination.

Senior OAG management supervision and review – As mentioned above, the AAG is usually closely involved in the special examination, and after performing a detailed review approves all key documents (plan, final report, management letter) submitted to the corporation and the Report Clearance Memorandum (RCM). The DAG and/or the AG are on all advisory committees, are kept up to date on any significant issues, and review and approve the final report and the RCM.

Second reviewer – Usually an experienced principal or AAG, the second reviewer provides additional quality assurance for all special examinations except for those of six small, low–risk corporations. The reviewer should be consulted throughout the examination on all key issues and should be invited to all advisory committee meetings. The reviewer's functions are accomplished mainly through discussions with the principal and the AAG, and through the review of the examination plan, audit programs and files for critical areas (as necessary), and the draft examination report.

Functional responsibility leader for Special Examinations – The FRL can be consulted throughout the examination on any pertinent general practice issue, and is a member of each special examination advisory committee. The FRL reviews and comments on all special examination draft plans and reports and, at a minimum, is consulted at the following critical times:

- Planning Phase: when the team is discussing expected corporate results, risks, key areas and general criteria, and when it is drafting the examination plan;
- Conducting Phase: when the team is discussing the significance of deficiencies and reporting strategies; and

- Reporting Phase: when the team is drafting the long–form special examination report.

The FRL team's expertise is maintained through training, practice exchanges and access to internal and external specialists and experts.

Other functional responsibility leaders – In order to provide consistency in judgments in complex areas, the Office has appointed FRLs for certain subject matter areas and areas of audit specialization. While most special examination issues are under the responsibility of the FRL for special examinations, there may be other areas where the advice of certain FRLs might be sought. Those FRLs are identified by the audit principal in consultation with the AAG.

Access to specialists and experts – Special examination teams consult internal and external specialists and experts, as necessary, when dealing with unusual, complex or controversial issues, or with other matters requiring specialized knowledge or experience. The FRL holds similar consultations when developing methodology.

Advisory Committees – Advisory Committees are composed of both internal members (including the FRL, the principal or the AAG responsible for the previous special examination, the second reviewer, the AAG of Crown Corporations and/or the DAG of Audit Operations and/or the AG), and external members (usually specialists or renowned experts in the field examined). The special examination team consults the advisory committee at least twice, and sometimes more often for larger examinations. At the end of the survey phase, the committee provides advice on the draft examination plan, including expected corporate results, risks, key areas and general criteria. The advisory committee contributes again at the end of the examination phase, advising on the draft examination report and proposed findings, significant deficiencies and reporting strategy.

Special Examination Management Committee – The Special Examination Management Committee (SEMC) is composed of the DAG of the Audit Operations Branch and the AAGs/DAG responsible for special examinations. The committee meets bi–monthly or as required to: advise the FRL on key practice issues; to monitor special examinations; to identify key messages to special examination teams; and to identify significant issues that should be brought to the attention of the AG.

Practice Development Committee – The Practice Development Committee (PDC) is composed of a dozen senior OAG staff. All major special examination methodology documents and practice issues are tabled, reviewed and discussed at these committee meetings.

Input from Crown corporations and stakeholders – The special examination process includes consultations with board members and stakeholders, getting senior management and internal audit buy–in and involvement, and having the corporation review and comment on major examination documents and issues, including criteria and findings.

Survey of Crown corporations – Crown corporation chairs and CEOs were surveyed to seek their views on second–cycle special examinations. The results of this survey enabled the Office to focus in the third cycle on added value to corporations through long–form reports, concentrating on significant issues only, thus shortening the duration of the examination. In order to determine the level of added value and the relevance to the client in the third cycle, we will continue to survey Crown corporations and to monitor actions taken in response to our findings.

Development of a Special Examination cycle plan – The FRL, in consultation with examination Principals and AAGs prepares a cycle plan for approval by the Special Examination Management Committee. To reduce the strain on resources, the plan typically includes rescheduling of several special examinations to smooth the peak period

that typically occurs in the last two years of cycles. The plan also identifies targets for costs and duration, thus increasing practitioners' awareness of the need to focus on significant issues only. As well, in order to ensure that people with the right knowledge, experience and training are available when needed, specific staff and consultants are identified and confirmed early.

Established and consistently applied methodology – The special examination methodology is comprehensive, and is fine–tuned as necessary over time. The following measures will ensure consistency in the methodology's application:

- the FRL reviews key documents and on–going consultations with all special examination teams;
- most principals participate in more than one examination cycle;
- teams can use ISES, with its standard forms, questions and templates of key documents;
- the same second reviewer is used for corporations of similar type;
- there are meetings between teams working on related or similar result areas (pilotage, financial and cultural institutions); and
- the FRL and the AG or the DAG of the Audit Operations Branch are on all advisory committees.

Continuing development of other OAG positions – The FRL, in consultation with practitioners, the SEMC and external experts, develops positions and related methodology where needed for emerging or complex special examination issues.

Participation of senior practitioners – The FRL consults special examination principals and AAGs regularly on issues that affect them, and asks them to identify topics of interest for senior practitioners' workshops and to comment on a range of specified topics, such as:

- the proposed long–term strategic functional plan for special examinations;
- a proposed survey of corporation chairs and CEOs;
- proposed special examination policies; and
- a draft position paper on the examination of governance practices in Crown corporations.

Provision of required training and practice exchanges – Senior practitioners' workshops are held every two years, or as requested, to discuss current practice issues and to exchange best practices. Practice exchanges have also been held with private–sector practitioners, and will be considered in future as required. As well, the FRL team offers training in a number of ways: through just–in–time training for methodology and ISES on a team–by–team basis; through meetings between teams working on related or similar–result areas (pilotage, financial and cultural institutions); and on a one–on–one basis as re uired.

Improved practice through electronic tool – ISES, a system of electronic working papers for special examinations, was launched in 1996, and improvements are ongoing. This Lotus Notes–based application provides users with improved ways to store and share information and to access guidance and methodology. It also helps to promote a results–orientation focus, sufficiency of evidence, and consistency in applying the methodology.

Monitoring of special examinations – For each special examination, the FRL keeps track of actual costs, timing and duration compared to what had been planned, and

compared to previous cycle experience, and provides this information regularly to the **SEMC.**

Review of lessons learned – The FRL team in consultation with SEMC, has performed a review of lessons learned from the first two cycles of special examinations and has developed key messages for the third cycle. This process has given practitioners a clear sense of the Office's priorities for the third cycle, which include: minimizing special examination costs without compromising value and without increasing risk unduly, and providing added value to corporations by focussing on significant issues only, long–form reports, transfer of other information, and shorter duration.

Continuous monitoring of external initiatives and developments – The FRL team including the AAG of the Crown Corporations Group, keeps abreast of new external developments that might impact on Crown corporations or special examination practice issues (for example, new Treasury Board Guidelines for Crown corporations, new Canadian Institute of Chartered Accountants (CICA) Standards for assurance engagements, and new private–sector publications on performance measurement).

Independent review – Special examinations undergo regular independent reviews by the Office's Professional Practice and Review Group, whose main objective is to provide quality assurance to the AG and, if necessary, make recommendations for improvement.

Appendix 2: Corporate Governance Considerations in a Special Examination

(also refer to Chapter 5)

Corporate governance practices in Crown corporations involve overseeing the direction and management of these corporations so that they effectively fulfil their mandates. Good corporate governance can contribute to the achievement of corporations' public policy and commercial objectives. The division of powers and responsibilities among Parliament, the minister, the board of directors and management establishes key accountability mechanisms. In particular, boards of directors have overall responsibility for the management of the affairs of the corporation, with a view to the best interests of the corporation and the long-term interests of the shareholders. In many ways, the activities of the board influence the corporation's major management systems and practices and the performance of the corporation. The board oversees the management of the corporation and should be involved substantively in:

- approving the strategic direction and the corporate plan;
- ensuring that the potential threats and principal risks are identified and managed;
- approving major decisions;
- monitoring performance; and
- approving management's succession plan, including appointing, training, compensating and monitoring senior management.

An important input in "understanding the business" therefore requires a sound understanding of corporate governance practices. Teams can acquire this understanding in a number of ways:

- through maintaining contact with the organization as part of the annual audit and attending audit committee and board of directors meetings;
- through reviewing of the terms of reference of the board and its committees, minutes of their meetings and information presented to them;
- through reviewing any work the board itself may have commissioned concerning its own functioning or governance practices;
- through reviewing the corporation's reporting of its governance practices, as is strongly recommended by the government's corporate governance guidelines; and
- through interviews with board members.

The principal and AAG responsible for the special examination should thoroughly understand the corporation's governance practices and, in particular, should directly participate in any interviews with board members on this subject.

Examination teams should use the key questions outlined below in italic as a guide when planning a special examination. This vital understanding is then brought to bear in the remaining phases of the examination, including the selection of key areas for in-depth examination. Governance per se would not normally be selected as a key area for in-depth examination. Rather, any audit observations on governance systems and practices formulated during the planning phase might be relevant during the analysis of the "problem, cause and effect" for other findings of the special examination. In those rare cases where, during the planning stage, corporate governance systems and practices

are found to be particularly weak, governance might be selected as a key area for in–depth examination.

The following list of questions draws extensively on the guidelines on corporate governance issued by the Treasury Board Secretariat. Elaborations and additions are provided in certain areas critical to the examiner. For example, we note the need for institutionalizing values and ethics.

Key Questions and Background Information

1. Functioning of the Board

Does the board of directors meet its corporate governance responsibilities, and do its procedures and practices function to assist the board and its individual members?

Understanding the board's effectiveness involves considering how well it has assumed its responsibility for the corporation's overall approach to governance issues.

In order to perform its work, the board should develop and approve a corporate governance working agenda. This agenda should outline the activities to be performed and identify the corporation's governance policies and practices. These policies and practices should be adequate to assist both the board and its individual members to fulfil their governance responsibilities.

The board's knowledge, skills, experience and understanding are all useful resources for input to orientation and education plans of individual directors and for the periodic renewal of the board. Also, the board of directors should regularly assess the effectiveness of its performance as it develops its working agenda and considers renewal of its membership.

2. Working with Senior Management

Has the board developed a working relationship with the CEO that enhances the board's effectiveness in overseeing management and at the same time allows the board to function with a perspective independent of that of management?

For the board of directors to oversee the management of the corporation, the board and management need to develop an effective working relationship and an understanding of their respective responsibilities. The allocation of responsibilities should help the board to act as an advisor and as a sounding board for the CEO. This allocation should:

- establish a clear mutual understanding of roles and expectations;
- minimize the board's involvement in the corporation's day–to–day affairs;
- enhance the importance of the board's role in the development of the strategic direction;
- ensure that the board reviews and approves appropriate decisions; and
- ensure that the board receives information on all significant developments and issues.

The board's ability to work closely with management and, at the same time, to function with a perspective independent of that of management is central to good corporate governance. Appropriate structures, processes and procedures should be in place to allow directors to maintain an independent perspective.

3. Accountability of the CEO

Does the board evaluate the CEO's performance against the established duties and objectives agreed to by the board and the CEO at the start of each year, thereby ensuring that the CEO achieves performance expectations and deals with any performance deficiencies?

The CEO should be clearly accountable to the board. Annually, the board should formally evaluate the CEO's performance against the duties and objectives agreed to by the board and the CEO.

4. Information

Does the board receive the information necessary to perform its work?

The board must receive the information necessary to perform its work, and must have confidence in the integrity of the information provided by the corporation's information systems and management practices.

5. Reporting

Does the board ensure that the corporation's external reports reliably communicate, in a timely and comprehensive manner, all the information about the significant issues confronting the corporation, its performance and financial viability, and its ability to fulfil its mandate?

The board of directors should ensure that the corporation's external reports meet stakeholders' needs. The reports should communicate in a timely manner information about the board's performance, its financial viability, its ability to fulfil its mandate, and the significant issues confronting the corporation. The board should ensure that its corporate governance policies and practices are described in the annual report.

6. Assurance

Does the board have assurance about the integrity of corporate information and of the corporation's internal control systems?

The board should be able to rely on the corporation's internal control systems and on the internal and external audit systems for assurance about the integrity of the information the board receives.

7. Relationship with the minister

Does the board ensure that both it and the minister have a mutual understanding of the corporation's performance, planned strategies and objectives, and the major issues confronting it?

The board should maintain lines of communication with the minister appropriate to the needs and obligations of the corporation. In addition to the normal reports, the chairperson, on behalf of the board, should advise the appropriate minister when the board considers it necessary.

8. Values and Ethics

Has the board ensured that appropriate values and ethics have been built into the corporate culture to help guide the behaviour of employees?

Values and ethics standards should guide the activities and behaviour of the corporation's managers and other employees. These standards should be built into the culture of the

corporation and should be understood by all. The board should endorse these values and ethics, and ensure that appropriate practices exist to support and maintain their currency and relevance.

9. Public Policy

Does the board understand the corporation's public policy objectives, and does it ensure the appropriateness of the balancing of these public policy objectives with its commercial objectives? Does the board periodically ensure the continuing relevance of the legislated mandate?

The board of directors should ensure that the corporation's objectives as a Crown corporation are appropriate. The board should ensure that the corporation's public policy objectives support its legislated mandate. The board should ensure that the public policy objectives are well understood within the organization and that a suitable balance is struck between the achievement of the public policy objectives and the achievement of the commercial objectives. The board should periodically ensure that the legislated mandate continues to be relevant.

Conclusion

Once the special examination is completed, the examiner should be able to answer the following broad--based questions: Does corporate governance contribute to the fulfilment of the corporation's mandate and to the achievement of both its public policy and commercial objectives? Does the board of directors contribute substantively to the choice of corporate objectives and strategies, approve major decisions, set performance expectations, and monitor performance on an ongoing basis?

Recommended reading:

Corporate Governance in Crown Corporations and Other Public Enterprises: Guidelines, Department of Finance and the Treasury Board Secretariat of Canada, Conference Board of Canada, 1996.

Information, the Currency of Corporate Governance – A Board Information Strategy, Canadian Comprehensive Auditing Foundation, Ottawa, 1997

Other Information Sources:

Directors of Crown Corporations: An Introductory Guide to Their Roles and Responsibilities, Department of Finance and the Treasury Board Secretariat of Canada, Conference Board of Canada, Ottawa, July 1993.

Conference Proceedings. Corporate Governance: Improving the Effectiveness of Crown Corporation Boards, October 6, 1994, Department of Finance and the Treasury Board Secretariat of Canada, Conference Board of Canada, Ottawa, January 1995.

Conflict of Interest and Post–Employment Code for Public Office Holders, Office of the Ethics Counsellor, June 1994.

Criteria for Board Control – Guidance for Directors – Governance Processes for Control, Canadian Institute of Chartered Accountants, 1995.

"Where Were the Directors?": Guidelines for Improved Corporate Governance in Canada, Toronto Stock Exchange, Toronto, December 1994.

Appendix 3: Template of Special Examination Report

[ENTITY'S NAME]

SPECIAL EXAMINATION REPORT

PRESENTED TO THE
BOARD OF DIRECTORS

on [dd mmmm yyyy (date of meeting)]

This DRAFT (# _____ of _____):

- is protected for discussion purposes only;
- is the property of the Office of the Auditor General;
- cannot be photocopied; and
- must be returned to the Office of the Auditor General.

[ENTITY'S NAME]

SPECIAL EXAMINATION REPORT

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OPINION ____ ***4***

[SIGNIFICANT DEFICIENCIES] ____ ***4***

APPENDICES

Systems and practices and related examination criteria ____ ***A***

[Non–significant areas of concern or for improvement ____ ***B]***

[Significant Deficiency(ies) ____ ***B]***

To: The Board of Directors of [entity's name]

OBJECTIVES, SCOPE AND EXAMINATION CRITERIA

As required by Part X of the *Financial Administration Act* (FAA), we have carried out a special examination of the financial and management control and information systems and management practices maintained by [entity's name]. The corporation is required by paragraphs 131(1)(b) and 131(2)(a) and (c) of the FAA to maintain these systems and practices in such manner as will provide reasonable assurance that:

- the assets of the corporation are safeguarded and controlled;
- the financial, human and physical resources of the corporation are managed economically and efficiently; and
- the operations of the corporation are carried out effectively.

Our responsibility is to express an opinion on whether, during the period under examination from [dd mmmm yyyy] to [dd mmmm yyyy], there was reasonable assurance that there were no significant deficiencies in the systems and practices examined.

A plan for the examination, based on our survey of the corporation's systems and practices, was submitted to the audit committee on [dd mmmm yyyy]. The plan included the criteria to be applied in the special examination. The criteria were selected specifically for this examination by our Office in consultation with the Corporation. They were selected based on our knowledge and experience with value for money auditing by reference to legislative and regulatory requirements, to standards and practices followed by the Corporation and by other organizations and to professional literature. These criteria are listed in Appendix A.

The plan also identified those systems and practices that we considered to be essential to providing the corporation with reasonable assurance with respect to its assets being safeguarded and controlled, its resources being managed economically and efficiently, and its operations being carried out effectively. [With the exception(s) described in the following paragraph] these systems and practices were selected for detailed examination. Other systems and practices of the corporation, although covered in the survey, were excluded from detailed examination because our analysis of the significance and risks associated with them indicated that, during the period under examination, they were not critical to providing the corporation with reasonable assurance as required by paragraphs 131(2)(a) and (c) of the FAA.

[If there were any specific scope limitations, they would be noted here].

Our examination was made in accordance with the plan, as well as standards for assurance engagements, recommended by the Canadian Institute of Chartered Accountants. Accordingly, it included such tests and other procedures as we considered necessary in the circumstances. In carrying out the special examination, we relied on internal audits of [systems, practices, organizational components, etc.].

CONTEXT

[Opportunity to discuss the corporation's mandate, environment, challenges, constrains, etc. If reporting a significant deficiency(ies), this may be the one place where we can offer balance by recognizing progress and efforts made.]

[The remaining sections of the report should provide our assessment of the corporation. It should include information that is of interest to the corporation's board. It could include, for example, a discussion of the corporation's expected corporate results, how well the corporation is managing to those results, and actual results achieved. Might also be described: major challenges or risks facing the corporation (particularly where they continue to significantly jeopardize the achievement of results); and deficiencies, that although not considered to be "significant deficiencies", require the board's continued attention. In short, all information arising from the special examination which we would like to communicate to the board of directors should be included in the special examination report.]

FINDINGS

[Observations should be listed by Business Activity, by Key Area Examined In–Depth or by ECR/Critical Success Factor. This is a good opportunity to offer board members value–added by offering useful information for them and at the same time give justice to the work done.]

[If you wish to be able to update the table of contents automatically to include any sub–titles you create under this section, use the "Style" option under the Format menu in Word, and select "Heading 2".]

[No significant deficiency reported:]
[We should only talk about what's important for the corporation (i.e., what does the corporation have to do well to succeed), are they managing the risks well, if so how and if not, why not? We have to be careful not to include minor points. At the very least, we should provide sufficient information to explain our overall opinion. Although there are no significant deficiencies, this section should also discuss concerns or areas for improvement that although not of a significant nature, should be brought to the board's attention. Another option is to discuss these concerns in appendix B. Examiners have to be careful not to contradict the overall opinion.]

[This is also where we can recognize any progress made in these areas since the last special examination.]

[For a medium size corporation, this section could easily be four or five pages long.]

[One or more significant deficiencies are reported:]
[If there are only a few significant deficiencies, this section could also discuss the other key areas examined (what is working well and what are the areas for improvement). However, if there are numerous significant deficiencies, it may be preferable not to have this section at all in which case the report would go from "Context" right to "Opinion".]

OPINION

[As discussed above, we did not examine…(any scope limitations need to be repeated in the opinion paragraph)] **In our opinion, with respect to the criteria established, there is reasonable assurance that, [except as noted below,] there are no significant deficiencies in the systems and practices examined.**

[SIGNIFICANT DEFICIENCIES]

[Significant deficiency(ies) title followed by a description of the significant deficiency(ies) with their own subtitles Style your titles "Heading 2" to be able to update the table of contents automatically.]

[Provide a full but succinct description of the nature, extent, cause and effects of the significant deficiencies. The effects should be stated in terms of the manner in which the deficiencies prevent the corporation from having reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, or that its operations being carried out effectively, as the case may be. There is no need for recommendations when the cause, problem and effects are well identified.]

[see endnote for additional considerations which are likely to influence the report format]*

[Signature]
L. Denis Desautels, FCA
Auditor General of Canada

Ottawa, Canada
[date of field work completion]

Appendix A:

Systems and practices and related examination criteria

[We are no longer looking for a detailed list of systems and practices examined and a separate list of criteria, but would rather see, in this appendix, each key area subject to in–depth examination and the related criteria.]

Appendix B:

Other areas of concern or for improvement

[If no significant deficiency reported, this appendix would discuss the other areas of concern/for improvement that would be of interest to board members, if not already discussed in the observations section. This would not necessarily replace the need for a separate management letter or detailed findings sheet for management.]

OR

Significant Deficiency(ies)

[Elaboration of significant deficiency(ies) raised in the main report if required.]

[also, see endnote at the end of this document]*